STUDIES IN CAPITAL & INVESTMENT

Edited by G. D. H. COLE

Being a volume of
New Fabian Research Bureau
Studies in Socialist Problems

By

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INTRODUCTION

This book consists of eight essays produced by the Economic Section of the Bureau on a number of related financial subjects. It is hoped that it will be followed by further studies on other subjects as the work of the Bureau progresses. One volume of collected studies on these lines, *Twelve Studies in Soviet Russia*, has already been published by the Bureau and has met with a favourable reception.

It should be pointed out that in this collection of essays, as in all other publications of the Bureau, the author is solely responsible for the materials included in his study and for the views expressed. The Bureau is not a policy-making but a research organisation. It allows its members complete freedom of expression, provided they believe that a Socialist system affords the right solution for the problems of the present day and that the organised Labour Movement should be used to accomplish this end. Care has been taken, however, to see that adequate criticism both of the facts and of the views contained in these studies was obtained before publication was decided on.

The book starts with two essays of general economic and historical interest. Mr. Dickinson describes the breakdown of the capitalist system and its failure to

provide either security or comfort for the ordinary man, whilst G. D. H. Cole traces the growth of the modern form of capitalist enterprise. The later studies are detailed analyses of important financial questions which have long needed an examination from the Socialist point of view. They will be found to contain much new material, particularly in their statistics. In other cases material which has not previously been related is brought together. A number of the studies deal with the use that is made of national savings. If a Socialist Government is to embark upon any big plan of national development, it will be vital to its success to know beforehand how far, and in what channels, at home and abroad, savings are now put to a fruitful or unfruitful use. Mr. Radice further analyses this in a discussion of the attitude that the State ought to take up concerning investment in the transitional stage towards a Socialist State, both to prevent a flight of capital overseas and to direct internal investments into suitable channels.

The two following subjects of considerable interest are dealt with by Mr. Francis Williams and Mr. Watkins. It is asserted by many Socialists that insurance ought to be socialised, both to provide better services to policy-holders and to see that the large investments made through the insurance companies are used in the national interest. The enormous growth of the building societies since the war has taken place largely unrecognised by Socialists; the effects of this growth,

both upon savings and private enterprise building, have been far-reaching.

I have no desire in this Introduction to deal with any of the conclusions reached by the various authors. I should, however, like to recommend those who, as a result of reading these studies, become interested in the New Fabian Research Bureau, to write to the General Secretary, 17 John Street, W.C.1, to obtain particulars about its organisation and the valuable work it is carrying out.

CHRISTOPHER ADDISON
Chairman,
N.F.R.B.

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THE FAILURE OF ECONOMIC INDIVIDUALISM

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THE FAILURE OF ECONOMIC INDIVIDUALISM

I

THE FUNDAMENTAL PURPOSE of all economic life is the satisfaction of human needs with resources that are limited in comparison with the needs clamouring for satisfaction. On the one hand are needs—needs for nourishment, shelter, entertainment, solitude, fellowship—complicated by infinite gradations in quality and variety, and by countless vagaries of individual taste and of collective fashion. On the other hand are the resources at the disposal of society —raw materials, sunlight in its protean manifestations, the time of human agents. These resources, either in their crude form, or combined and recombined into instruments of production, semimanufactured goods, and finished goods, are requisite to the satisfaction of most human needs. Even the most intellectual and spiritual needs make some call upon material resources, or upon human labour power, for their satisfaction : for paper, printing machines, and typographers' labour ; for masonry and timber, and the labour of architects and builders ; for maple wood and catgut, and the time of skilled fiddle-makers. These resources are scarce relative to the possible

needs for which they could be used. There may be enough wheat in the world to give everyone enough bread, but there is probably not enough to give everyone all the cake he wants ; moreover, the growing of wheat takes its toll of the cultivators' time, which might otherwise be spent in leisure, or other kinds of labour, satisfying other needs. Even if ultimate material resources are so abundant as to obviate any need for economising them, human labour is scarce in comparison with the multifarious purposes in which it might be expended. There are only twenty-four hours in the day, and everybody could use them all in work, without satisfying their neighbours' desires. But man must rest from labour in order to enjoy the fruits of labour ; hence the demand for leisure competes with the demand for production, and time must indeed be carefully husbanded if the needs of man are to obtain anything like the greatest satisfaction of which they are capable.

The fundamental problem, then, of every economic society is the allotment of limited resources (including human labour power among the resources) to the satisfaction of needs, so as to secure the maximum of satisfaction. It is essentially a quantitative problem as well as a qualitative one. It is not only a question of what needs are to be satisfied, but to what extent, as compared with other needs requiring satisfaction ; not only a question of what resources are to be made use of, but the proportions in which a given quantity

of resources is to be divided among different uses, all involving different and competing satisfactions. It is this quantitative problem that is the essential economic problem. It is here that we can distinguish between technology and economics. The agronomist can tell us the most efficient method of growing wheat under given conditions, and, given the quantity of wheat desired, can tell us the quantity of land and labour required for the production of that quantity. He can tell us the same for the growing of cotton and the rearing of cattle. But the determination of the quantity of wheat, cotton, and meat required for a certain population, with certain tastes and standards of living, balancing the relative satisfactions afforded by wheat, cotton, and meat as against the quantities of land and labour required for their production—this is the problem of the economist.

Similarly, the metallurgist can advise on the best methods of producing steel of a given quality, and on the quantitative relations between ore and coke, while the expert in structural steel work can explain the advantages of steel for building purposes as compared with brick, stone, or wood ; but the ultimate problems regarding the quantity of steel to be produced, considering its possible uses in the consumption of resources used up in its making, the allotment of the steel produced to different uses, the making of steel against alternative materials in various branches of construction, taking into consideration the resources

consumed in the production of the various alternatives—these are all economic problems. We may say that the proper work of the economist begins after that of the technician has been done.

Having thus briefly stated the nature of the economic problem, let us consider how its solution has been attempted in different types of society.

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The capitalist method of regulating economic affairs consists of two main parts—to wit, the price-system and the system of private property.

Within the price-system, all goods and services, both those that are immediately consumable and those which are used in the course of producing other goods, are sold at a price. The price of a commodity has two functions, one primary, the other secondary. The primary function of price is to choke off demand until effective demand (i.e. demand at a price) is equal to the available supply. If the commodity in question is not freely reproducible, such as land, wine of a certain year, first folios, and works of Gauguin, the matter ends here. Keen demand means a high price; slack demand, a low price; and the available supply of the good is allocated to those persons whose demand, as expressed by their willingness to pay, is most intense.

But most commodities are capable of being produced in greater or less quantities, with greater or less

technical difficulty. And here price assumes its secondary function of regulating supply. Reproducible commodities are made from other commodities—raw materials, fuel, the use of machinery and buildings, human labour power—all of which have their prices. These prices are the costs of the commodity into whose production they enter; their sum is its cost of production. Cost of production is a touchstone of the economic worth-whileness of a given line of production. If the price of a commodity, as determined by demand, exceeds its cost, the producer of it receives a surplus which encourages him and other producers, or potential producers, of the same line of goods to increase output. In order to sell the increased output, the price of the good must be lowered until it approaches the limit of base cost. At the same time more resources have been attracted to this line of production, resources that were previously unused, or used in ways less productive as measured by the touchstone of price and cost. If the price of a commodity is below its cost, production is carried on at a loss, and producers are impelled to reduce output, either closing down their businesses or taking to the production of something else, until the reduced supply drives prices up into the neighbourhood of cost. At the same time fewer resources are used in this branch of production, and unused resources are driven into other and more productive uses. Thus the price of reproducible articles tends towards the cost.

In this way demand and supply are equated under the price-system. Moreover, resources are driven into uses where they are wanted, and driven out of uses where they are not wanted. The same applies to different methods of making the same thing, and to producers of different efficiency in the same line of business; the system of price and cost tends to eliminate the inefficient, and to promote the survival of the fittest.

The system of private property means that all resources capable of being used in production are owned by private individuals, to whom is paid their price under the pricing system, and who have absolute discretion as to how those resources shall be used. It is to the interest of the private owner so to use the resources under his control as to receive the highest price for them. In particular a free man's labour power is his own, to dispose of as he thinks fit. He can either sell his services directly to a consumer (as a domestic servant or family doctor does), or incorporate his labour in some material commodity and sell it directly (as peasant producers, a working tailor, or an author-publisher), or he can sell his services to an undertaker, who combines them with other constituent goods and markets the finished product, making any profit he can out of the difference between the price of the product and the price (wage) that he pays the maker for his services. Since most production requires expensive resources other than

the services of the labourer, and since most labourers have not the means to purchase and tend these resources themselves and organise the selling of the product, the vast majority of labourers accept this third method and sell their labour power to an undertaker for an agreed price or wage. This is what is called the wage-system.

To complete the circle of the system it must be observed that the proceeds of the sale or hire of resources (including labour power) form each individual's income. (If a man has no property, and can render no service for which there is an effective demand, he has no income.) This income is what he offers for finished goods. We thus have a closed circle : the effective demand for commodities is derived from the earnings imputed to the participants in the process of production ; the earnings of the producers are derived from the payments made for commodities. This circle is apt at times to become a vicious circle ; we then have the paradox of ill-housed workers and out-of-work builders, of wheat that is unsaleable and people who cannot buy bread. This is expressed more technically in the failure of the co-ordination of demand and supply.

There is thus a tendency for a definite equilibrium to be established between men's desires on the one hand and the limited resources available for satisfying them on the other hand. If the system works smoothly, all needs will be satisfied up to a certain level of

importance defined by the available resources, and all resources will be put to the most effective use in satisfying need. For, if not, people will transfer purchasing power from the purchase of goods that satisfy less important needs to those that satisfy more important needs, and people will transfer resources they control from less to more productive uses. It must be clearly realised, however, that, under the individualistic system, importance of needs and the productiveness of resources are measured by the purchasing power offered by the consumer, which in turn depends upon the share of the social product imputed to him.

It is clear that, if this system is to work smoothly and freely, the prices of commodities must be capable of ready adjustment to changes in the conditions of supply and demand. In other words, there must be a well-organised market for them. In the absence of such a market, maladjustment will occur : the price of a commodity may remain high without its supply being stimulated, or its price may remain low and the resources that enter into it, instead of being forced into other and more productive uses, may remain where they are, and receive an abnormally low remuneration.

Now the force that is usually relied upon to effect the necessary adjustments quickly is that of competition. Competition between vendors of the same article will keep the price down to the least that is necessary to remunerate the factors of production, and will

ensure the production of the greatest output that can be possibly sold. Competition between users of factors of production will tend to push the price of factors up to the highest point at which they can secure full employment, and, by driving them out of unprofitable occupations, will also ensure their most productive use. Thus the price-system, private property, and competition are the three legs of the tripod on which the capitalist system rests.

Each of these three legs may be weakened. Thus, in wartime, both the price-system and private property have been seriously assailed : the first by schemes of rationing and price-control, which hampered the free working of supply and demand, the latter by requisitions and confiscations. But in normal times the price-system is little interfered with in this way. The institution of private property is slightly modified by what is called " eminent domain," the right of the State to acquire, on paying full compensation, private property for public purposes.

Even private corporations may acquire similar rights from the State by statute for their own purposes, if these serve a public end, such as the laying of a railway track, of telegraph wires, or of gas mains. Private property is also modified by the existence of public property in the means of production, i.e. of State or municipally owned railways, canals, tramways, electric power stations, telegraphs, telephones, breweries, canneries, brickworks, printing works,

steelworks, mines, forests, spas, racecourses, tea-shops, bread-shops, milk-shops, meat-shops, banking businesses, insurance businesses, and other enterprises. But, since these are carried on more or less in the same way as privately owned businesses of the same nature, competing directly or indirectly with private enterprise both in the sale of goods and services and in the purchasing and hire of factors of production, and since they are usually accompanied by the creation of some kind of interest-bearing stocks or bonds, they do not change the institution of private property quite so deeply as some of the advocates of public ownership think. The third leg of the tripod, however, is undergoing considerable changes. Economic agents who formerly competed among themselves for the privilege of selling some product or some service now find it more to their collective advantage to agree upon the terms on which their contributions will be forthcoming. Not only manufacturers, but also contractors, merchants, and retailers, are organised into rings, associations, conferences, cartels, and trusts, having as their chief object maintenance of a smaller output, and therefore a higher price, than would be established under a competitive régime. Workers, too, both manual and professional, have their unions and associations, which try to eliminate competition among workers so far as it takes the form of underbidding one another for a given job, and to substitute collective for individual bargaining about the terms

of the wage-, salary-, and fee-contract. Unless, however, a trade union can restrict entry into the occupation it is concerned with, which is not common, it is unable, without causing a certain amount of unemployment, to raise the rate of wages above the level that would be established by effective competition among employers. It is therefore necessary, in dealing with the capitalist system, to consider how far competition is really effective, and how far monopoly has established itself.

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One further important feature of the capitalist system must be mentioned.

We have seen how the individualist system is supposed to work. Now let us see if it does in fact work in this way : we shall see that it does not, that there are numerous defects in the machinery. Having examined these cases of defective function, we shall next turn to certain consequences of the individualist system which are inseparable from it, but which most people consider socially undesirable.

The defects in the capitalist system may be arranged under three heads : firstly, those deviations from the ideal equilibrium which occur even in the fully competitive phase of the system ; secondly, those that are due to the emergence of monopoly ; thirdly, the dynamic disturbances associated with the working of the monetary system.

The defects in the price-system are due to the fact that, even when competition is effective, it does not in practice work as it is supposed to in theory. In place of the perfectly flexible system of theory, with its infinite possibilities of fine adjustment to every variation in human needs and every change in the skill or efficiency of the agents at society's disposal for meeting these needs, we have a system that in some places, such as the market for stocks and shares and the market for the chief raw materials, is too sensitive and flexible, and in others, such as the condition of sale of many manufactured articles, of most goods in retail trade, and of labourers' services, is too rigid and unresponsive.

Chief among the defects of the pure competitive system are those due to ignorance. Production is going on everywhere in self-contained units, many large, but a surprising number still quite small, working with only approximate knowledge of what other units are doing. Every undertaking keeps its costs a dark secret. In spite of the patent law, there are still secret processes in industry. Although great advances have been made in publicity of prices, thanks to open, organised marketing, there is still little certain information available about quantities of goods changing hands or about stocks of goods that are being held. Still less is known about the magnitude of current production. Owing to this ignorance of entrepreneurs concerning one another's doings, the

production of any kind of commodity tends to go in bursts. After a shortage, prices rise high, and everyone increases output simultaneously. If markets are expanding, every manufacturer or trader thinks that he is going to get a bigger proportion of the new trade than his rivals : thus more goods are put on sale than the market can absorb. The result is over-production, and then everyone closes down works, or runs on short time. Thus pessimism, like optimism, is overdone. Production, instead of proceeding smoothly, runs in a series of spurts, with intervals of stagnation. The result is that productive equipment is not fully utilised, and more capital is required for a particular average rate of output than would be required if the output was spread more uniformly in time. Owing to the close interconnection of all branches of trade, this malady of maladjustment is infectious. In particular, this jerky nature of production is exaggerated in the industries that manufacture producers' goods (iron and steel, engineering, shipbuilding). When a boom occurs, manufacturers, anticipating a bigger share in the increased share of orders than they will in fact get, decide to extend their plant, give orders for more building and more machinery. The result is an increase of productive capacity beyond the point at which the market can absorb its products. Until the demand has grown up to the productive capacity, orders for new equipment cease almost wholly, and the trades that produce new equipment

stagnate until the next boom. The extremes of good and bad trade are generally more marked in these trades than in those producing goods for immediate consumption. Shipbuilding is a case in point.

Ignorance also hinders the flow of capital in the right amounts to new industries. Costs are mysteries of state, and profits are almost equally wrapped in darkness. Published balance-sheets of public joint stock companies are usually designed to conceal rather than to reveal the true state of affairs, while private companies and unincorporated firms publish no balance-sheets. Thus, while in theory new capital should flow into any industry or new process that shows more than normal returns, so equalising the rate of profit and increasing production in the directions in which it is most likely to satisfy consumers' needs, uncertainty of the actual state of affairs may keep new venturers out for some time, and enable the firms already established to make monopoly profits by restricting the output that would most fully satisfy demand. At the same time, relying on the absence of reliable information regarding output, costs, and profits, unscrupulous promoters may be directing other people's capital into branches of production that are already saturated, and where no real returns are to be had by the investor, as distinct from the promoter.

Closely associated with ignorance is a second defect of unregulated competing enterprise—to wit, the slowness of the response of production to the indications

afforded by price. This is most clearly seen when the period of production is long, as in the case of crops like tea and rubber, where no yield may be obtained for five, ten, or twelve years after the preparation of the ground ; in the case of mining or railway construction, where also much capital must be irrecoverably invested some years before any commensurate return is to be looked for. In such case, either—as in forestry—private enterprise is not forthcoming at all, and valuable resources are destroyed or left undeveloped until the State steps in, or, as in rubber, private enterprise does come forward, and produces oscillations of output more violent than those in other branches of production. If railway installation is left to private enterprise, it is either too timorous, and will not venture without guaranteed profits, or too venturesome, and creates a railway network in excess of the needs of the district. Examples in England of such over-building, with consequent duplication of facilities and wasteful competition, are the lines of the old S.E.R. and the London, Chatham & Dover Railway in Kent ; the G.E.R. main line to London, the Cheshire lines extension, and the Great Central lines in Lancashire, etc.

Another way in which the production shows itself unresponsive to the regulation of price is seen in the case of falling demand. The automatic response of a number of unco-ordinated producers to rising demand is to increase output ; given a reasonable prospect of

profit, it is easy to lay down new equipment for increased production. But it is much harder to adjust productive capacity to a falling demand. No one wishes to sacrifice himself for the good of the whole industry ; everyone plunges into a welter of cut-throat competition, hoping that out of the general carnage his firm will emerge triumphant over the corpses of his rivals. During the palmy days of capitalism, population was increasing and productivity per head was expanding so rapidly in the industrial countries that, although some industries might suffer a relative decline, few suffered an absolute shrinkage in production. A slowing down in the rate of growth was sufficient to adjust supply to demand. But now that the older countries are being faced with the possibility of an absolute and not only a relative set-back in some of their older style industries, it is being seen how powerless competitive capitalism is to adjust itself to such a state of things. The agonies of the British coal and other industries during the last fourteen years, painfully trying to disembarrass themselves of an excess of productive capacity above the world's probable future needs, are a terrible example of this. Rationalisation is all very well in an industry that has in front of it prospects of expansion and profitable sales ; it is a less attractive proposition for an industry that has to cut its losses. In such a case the competition of the redundant firms cuts profits so low that it is impossible even for efficient firms to raise the

capital necessary to adapt their equipment to the changed conditions. Even when the industry as a whole is flourishing, and there is no excess of total productive capacity, the process of eliminating inefficient producers is slower than might be expected. Competition, instead of ensuring that firms whose management is incompetent, whose equipment is out of date, or whose position is unfavourable for the market, shall be forced to make way for firms who are better circumstanced than they, causes firms to prolong their useless existence by expedients that keep costs high and profits low for the other firms and prevent their place being taken by those who would fill it better. They disappear in the long run, but they are an unconscionable time in dying, and their moribund corpses empest the economic air.

In this connection it is worth pointing out that all business men, and most apologists of the capitalist system, assume the existence of an indefinitely expanding market for most commodities. But with the approach of the population towards a stationary condition, and with the satiation of the more elementary wants (and of many not so elementary), a stage is bound to arise in most industries at which few new consumers can be discovered, and at which the market will begin to consist chiefly of renewals. At this stage much less productive capacity will be required than previously, and a severe slump will be inevitable. Nor can any imaginable cheapening of the product

help, for all needs are satiable, and after a point the demand for every commodity becomes inelastic. When every adult American buys every year two new motor-cars, one to drive and one to put in reserve, how can the motor-car industry maintain the output which has led up to this desirable consumption? But the cheapness of the cars is only possible on the basis of the enormous output. The very success of capitalism in solving the pattern of production is going to prove embarrassing. This nemesis of universal glut is already foreshadowed by the deep depression of nearly all raw-material producers. Wheat, coal, cotton, wool, rubber, coffee—all are being sold at prices far below what yields a reasonable livelihood to their producers. It is also foreshadowed by the fierce internecine struggles which have taken place in the U.S.A. of different industries catering for various kinds of consumption. The cigarette industry exploited the slim silhouette in its own interest by throwing discredit upon candy and chocolates as promoting corporeal grossness. The sweetstuff and soft-drink industries had an interest in Prohibition, and contributed to anti-saloon propaganda. The automobile, radio, and refrigerator interests developed hire purchase in order to get a hold upon the dimes and quarters that would otherwise go in more ephemeral pleasures. The latter—movies, cigarettes, candy, etc.—mobilised their resources to keep their hold of the consumer. The florists organised Mother's

Day in order to promote the buying of flowers. Culture has had to express itself in expensive goods—automobiles, clothes, furniture, mechanical gadgets in the home—in order to make consumption socially reputable. Intellectual tastes have been frowned upon by the great advertisement-bearing magazines, because they tend to make people poor consumers. Even poverty-stricken Europe is invaded by the cult of consumption for consumption's sake. The manufacturer who makes sound, durable goods is a traitor to his kind. The fact that a kind of material, a style of garment, is " in " this year is a sufficient reason for it to be " out " next year—new goods must be sold. Beauty and convenience are irrelevant to the manufacturer. Advertisement creates the impression that not to have the latest thing—however worthless and lacking in the power to satisfy genuine need—is to be socially inferior. The natural relations of consumption and production are being inverted ; the consumer is being looked upon as existing for the sake of the producer. (Here is meant by consumer, of course, the consumer with effective purchasing power, and by producer is meant the person who has invested his capital in a productive undertaking.)

Whereas, as we have seen, in some cases the price-system is too fixed and sluggish, in other cases it is so swiftly and delicately responsive that its fundamental purpose is likewise distorted. The market is sensitive not only to real changes in conditions of supply and

demand, but to imagined changes, and even to fictitious changes. In the absence of adequate public knowledge of relevant economic data too great sensitiveness in the price-system may be an evil, not a good. Hence in the great markets, where competition is most perfect, and price most responsive, there are the greatest opportunities for socially unproductive forms of money-making. Against genuine speculation—i.e. intelligent anticipation of price changes—not a word is intended ; such speculation fulfils a useful function by adjusting demand to supply, and in many cases making it possible for the producer to insure himself against price-changes during the process of production. But speculation by uninformed or reckless persons introduces irrational fluctuations into prices, which ultimately add to the costs of production and squander resources that would otherwise be used productively. What is even worse is that speculators on a large scale can deliberately falsify the working of the price-index by buying and selling against the objective indications of the market, and by influencing the more ignorant or suggestible part of the market, and may initiate irrational price-movements by which they subsequently profit (so-called " bulls " and " bears ").

Even if the above flaws in the competitive individualistic system could be removed—if the price-system became perfectly responsive and smoothly working, and if measurement and publicity replaced blind guessing and secrecy—even so, competition and

the price-system would not produce that perfect allocation of resources to the satisfaction of need that is postulated in theory. Economic decisions are taken by individual entrepreneurs, who guide their choices by the criterion of profit and loss in their own businesses. Only if the individual entrepreneur's profit and loss coincides with the profit and loss of the community as a whole—that is, only if his costs and receipts correspond to the real costs to the community and the real consumers' expenditure—will the decision of the individual entrepreneur be that which maximises the general economic welfare.

Now the costs of the individual businesses are frequently divergent from the real social costs. Sometimes they are higher, as when the business bears charges that should, by rights, lie elsewhere. Sometimes they are lower, as when the business is able to put charges that it should properly bear upon other shoulders. In the first case, the investment of the resources and the output of the industry will fall short of what is socially most desirable ; in the second case, both investment and output will be in excess.

In all these cases there is bound to be a socially undesirable allocation of resources so long as production is carried out by thousands of unco-ordinated units, and so long as private profit-making is the chief economic incentive. If individual cost and social costs do not correspond, the self-interest of employer and workman, of trader and customer, bargaining

however freely, will never establish that economic harmony which is the pride and joy of individualism. This is exemplified by the investment of capital and labour in parks, open spaces, in roads and other means of transport, which raise the value of property by much more than the promoters of the investment gain. If the London Underground obtained the whole unearned increment of urban site-values in suburbs to which it extended its system, it need not hesitate to embark upon schemes which would enormously improve London's transport facilities. As it is, communications are slower and more backward than they need be, and, when they are made, Londoners become richer without doing anything for it. This argument applies particularly to the investment of resources in equipping human beings, and in extending the boundaries of knowledge. Such expenditure brings in bounteous return, but rarely to the individual who makes it. Even a business firm which trains its own personnel, or carries out research in its own laboratories, only reaps a fraction of the harvest it sows. There is reason to believe that under individualism only a tithe of the resources is invested in education and scientific research that it would be socially desirable to invest.

On the other side of the picture, many businesses expand their activities on the basis of a concealed subsidy from the rest of the community. Smoke pours from a factory chimney, and adds to the cost of

domestic cleaning—rooms, curtains, clothes—for miles around, but the cost is not borne by the owner of the factory. Brewers' and public-house keepers' profits would make a poorer showing than they do if they were debited with the expenditure on police, hospitals, and poor relief that the drink trade is indirectly responsible for. Comparison between road and rail transport would redound more to the latter's credit were account taken of the cost of lighting and policing the roads, and the long toll of road accidents. One of the arguments put forward in favour of road transport is that the trader can put his own vehicles on the road, and so give himself a cheap advertisement. It is to be doubted whether it is in the public interest that the railway system should be impoverished, and its capital relegated to the scrap-heap, in order to boom the merits of so-and-so's tea or somebody's biscuits. Similarly, the shopkeeper who makes the street hideous with loud-speakers, or who desecrates the country with gaudy hoardings, may thereby increase his trade and his profits, but only because some of the costs of developing his business are borne by some of his unwilling fellow-citizens. In two ways particularly, real costs are thrown upon the public. One of the ways is the use for private gain of the diplomatic and military machinery of the State. If business traders in foreign countries get orders or concessions by means of diplomatic pressure or an exhibition of open force by their Government, or if manufacturers

of armaments and war materials use political influence to make Governments increase their orders of these things, then not only is the public saddled with the direct cost of these manœuvres, but, what is more serious, the indirect cost is in more armaments, in international bad feeling, and in war itself. The additional Dreadnoughts that were ordered as the result of the naval scare of 1909, that was itself occasioned by false information given to the Government about German naval preparations, were doubtless profitable to the firms that built them, but, if these firms were debited a share of the losses of 1914–18, it is probable that the margin of profit would be converted into a loss. The big Japanese banking interests which have been developing Manchuria will probably reap a rich reward now that the country has been pacified by Japanese arms, but they do not pay for the cost of the military expeditions. No workman's compensation is payable to the Japanese soldier who is disabled while following his normal occupation of making the Far East safe for Japanese capitalism. If you replace Manchuria by South Africa, and Japanese banking interests by the mine-owners in the Rand, you have the economic essentials of the war of 1899–1902.

The second way in which private interest receives a particularly important hidden subsidy is by the wasteful exploitation of human materials. (This case is the converse of that of education, mentioned above.)

Every child or young person employed in a blind-alley-occupation, and turned adrift at the threshold of adult life, ill equipped as a producer, and a potential receiver of public assistance and public charity ; every child or young person employed under conditions that undermine its health or make it incapable through fatigue, or cold, or hunger, from benefiting by education ; every woman overworked during the later stages of pregnancy, with resultant ill health and inefficiency to herself, and possibly to the child ; every worker, male or female, forced to work under exhausting conditions, and then, broken down in health or prematurely aged, thrown into the streets to make way for a fresh relay of " hands "—every one of these represents a waste of human capacities. Material equipment (non-human) may be scrapped when no longer of service. Humanity forbids that human beings should be destroyed when no longer making a profit for someone. Humanity even demands that the occupants of the scrap-heap for used-up workers should receive some sort of maintenance. But the costs of maintenance fall upon the general taxpayer or ratepayer (that is to say, largely upon the workers in work), and not upon the capitalist who profits from the employment in question. The same applies to the introduction of machinery and new methods of production that displace labour. Although ultimately adding to the productiveness of the whole social machine, its immediate effect may be to spread

unemployment, inefficiency, and misery far and wide. But the profits go to the capitalist and the losses are borne by the taxpayer. So the investment of resources is likely to go further and to be quicker in these directions than is socially justified. The deliberate restriction of output by monopolists involves the same consequences, without the advantage of ultimate social benefit to set off against it. So does the adoption of methods of work or organisation which unnecessarily increase the risk of unemployment, such as casual labour and the encouragement of a highly seasonal demand.

This evil has been greatly reduced in late years by methods of social control. The employment of children and young persons has been prohibited or regulated. Regulations for health and safety in factories, enforced by efficient inspection, the reduction by trade union and State action of the hours of labour, workmen's compensation laws, health and unemployment insurance, trade boards, compulsory decasualisation of labour—all these mitigate the evil. But it is an evil that is always with us potentially while the system of private enterprise lasts. It tends to break out in fresh directions, and, in spite of social legislation, it is always present. Recent technical developments in industry, replacing skilled manual work by machine-minding, tend to increase blind-alley occupations for young persons. The trend of demand, shifting more and more to personal services rather than tangible

goods, tends to increase the demand for casual labour.

Another defect of the individualistic system, even under competition, is the imperfection of the machinery for promoting new undertakings and providing new capital for undertakings already in existence. If old and unwanted businesses are a long time in dying, new businesses, that might employ capital and labour to good effect, are born as the result of a difficult labour. While the banking system and the bill-brokers provide a fairly efficient market for temporary uses of capital (mostly for investment of stocks in raw materials, goods in process, and in wage payments), and while there is the Stock Exchange—a fairly efficient organisation for the buying and selling of shares in the capital of companies already in existence—there is no comparable mechanism for facilitating the permanent investment of capital in new enterprises (capital permanently invested taking usually the form of land, buildings, machinery, and other permanent structures). Banks and investment trusts do something in this line, especially on the continent of Europe and in North America, but in Great Britain this highly important business is left mainly to the company promoter, and the divergence between individual profit and social advantage is wider here than almost anywhere else. At a time when the industries on which the ultimate prosperity of the country depends are starving for lack of the capital necessary for reconstruction and

rationalisation, capital is being poured in streams into hundreds of ephemeral courses whose ostensible object is to satisfy frivolous and superficial needs, and which do not even succeed in doing this. In 1928 there was a boom in promotion, during which 283 new issues of shares and industrial debentures were put upon the market. Altogether £116·8 million were subscribed, of which, on May 1, 1931, the market value was only £68·1 million. The net depreciation amounted to £48·7 million, or 42 per cent of the sums subscribed. Only 25 of the issues showed appreciation, including the Ford Motor Co. Ltd. (appreciation of nearly £5 million), the Underground Electric Railways, the London Power Co., two other power companies, and two motor services. On the other hand, 62 companies were wound up, and their capital, amounting to £13·7 million, was a total loss; 45 companies, with original capital £10·4 million, had no ascertainable value. Thus £24·1 million, or 21 per cent of the total, have no more contributed to the growth of the national wealth than if they had been expended in fireworks let off in the middle of the Sahara.[1] Chief among the holocaust were companies formed to exploit gramophones, cinematographic films, colour photography, artificial silk, safety glass, and automatic machines.

One of the advantages usually claimed for the individualistic system is that under it the consumers' interests are paramount. The touchstone of business,

[1] *Economic Journal*, December 1931, p. 577.

we are told, is profit, and unless the commodities offered for sale satisfy the consumer there will be no profit. Also, with numerous new adventurers eager to find some new channel for enterprise, no potential demand will long be unsatisfied.

So far we have been dealing with capitalism on the assumption that competition is effective. But the tendency of modern capitalism in all countries, and in all the main branches of modern production, is towards monopoly. This takes place in two ways: sometimes one firm out of many emerges dominant in the competitive struggle; in this case competition has destroyed itself. In other cases competition would be compatible with the simultaneous existence of a number of competing firms, but these, realising the disadvantages of competition, agree to measures of co-operation that take off the edge of the knife of commercial rivalry. These measures range from simple schemes of co-operation to standardise products and to modify trade practices, through trade associations for fixing prices, to permanent associations of firms in a trade, syndicates, pools, cartels, etc., and finally to still more intimate forms of aggregation—the holding company and the complete amalgamation. Alongside of this tendency to combine all firms manufacturing the same product (horizontal integration) goes a tendency for firms in one line of business to enter into close relations with, and finally to acquire or to absorb, firms in different but allied

lines (vertical integration). A firm may acquire firms making raw materials that it uses, or using the finished product that it makes, or producing the goods that compete with its own products. Thus steelworks acquire coalmines.

The tendency towards monopoly has two aspects, one beneficent, the other the reverse. In so far as combination abolishes the evils inherent in the unco-ordinated activity of hundreds of isolated business units, it is a good thing. A well-organised combine breaks down the barriers between firm and firm, makes cost sheets common property, compiles accurate statistics regarding stocks and sales, and pools patents and secret processes ; it goes on, further, to eliminate cross freighting (e.g. the simultaneous supply of the same kind of article to a London firm from a factory in Birmingham, and to a Birmingham firm from a factory in London), to concentrate specialised factories for different work, so that each concentrates on one small range of jobs, and to keep most of the factories steadily going at full capacity, concentrating the variable load on a few factories specially equipped for a fluctuating output. The buying and selling can be entrusted to specialised selling agencies, and the manufacturer left free to concentrate on production. The anarchy in the provision of new capital can be reduced to order. Products can be standardised, and the costs of keeping stocks reduced. In fact, nearly all the evils of competitive individualism can be averted,

except those due to the non-correspondence of individual with social cost. All this is a clear gain in social efficiency.[1]

Here, however, the other aspect of monopoly shows itself. The force ceases to act which, in competitive capitalism, drives production to the highest point compatible with the selling price not falling below the cost of production. Price can remain above cost and output below the capitalist "normal," and the monopolist is not compelled to increase his output. In fact, one of the purposes of the formation of associations, cartels, and combines is to pursue such a policy with regard to price and output, and thereby to extract additional profits—monopoly profit—from the pockets of the public. Under monopoly, price tends not to the figure which yields the maximum output and the most intensive utilisation of resources, but to the figure which yields maximum gain to the controller of the business. The economies of rationalisation can only be achieved at the cost of allowing the capitalist to restrict output and keep prices unnecessarily high.

The consequences of this, the restrictive aspect of monopoly, are more serious than at first appear. The general opinion regarding monopoly is that it leads to

[1] It must not be assumed that all forms of monopoly ensure these beneficent results. Complete trustification usually does; but loose forms of combination, especially the "pool" or "quota" system, retain the individual firms, with their irrational dividing-lines of the competitive system. There is little or no rationalisation of production, and, instead of concentrating on production in the most efficient firms, the inefficient are deliberately kept alive, combining the directorates only and keeping up the costs.

high prices. This is true, but it is not the whole truth. High prices cannot be maintained without restriction of output. Thus monopoly makes the national income less than it might be, in a given state of technique and organisation, and makes the available employment for capital and labour less than it would otherwise be.

The competition of entrepreneurs against each other for the available supplies of capital and labour tends to promote the fullest utilisation of both. It may pay a monopolistic combination of entrepreneurs to limit production to an amount which leaves both capital and labour unused. When a combine is formed, a considerable amount of the plant belonging to the lower competing firms is found to be superfluous, and is put out of commission. If this represents simply the scrapping of obsolete, inefficient, or badly situated plant, then, so far as the old output can be produced at a lower cost by the diminished amount of plant, it is all to the good : it may cause temporary hardship, but it ultimately benefits society through lower real costs. But if the closing down goes beyond this point, and equipment is reduced to maintain a monopolistic price, it represents a wilful and anti-social destruction of producing power, a form of sabotage worse than any committed by a striking workman, because its perpetrators have so much wider and greater an opportunity. That it is on occasions more profitable to organise scarcity than to organise plenty is shown by

the very common adoption of the device of the " pool " or " quota " for regulating output. Each firm in the association or cartel is allotted a quota—a definite percentage of the total output of the industry during a given period.

It is an interesting piece of economic analysis to forecast the trend of monopolistic capitalism if the present development of productive power continues. The effect of mechanical invention and rationalisation is to diminish the amount of labour required to produce a given quantity of goods. As we have seen, one of the advantages of competitive capitalism is to force the entrepreneur to share this benefit with the general body of consumers, and so, in the long run, society as a whole benefits. Everyone can obtain more goods in return for the same expenditure of effort ; the average man enjoys the fruits of progress in the form either of higher real income or of greater leisure—perhaps of both. Even under competition there will be a tendency, with the diminished importance of labour as compared with material equipment and organisation in production, for the relative share of labour in the social product to decline, but this will be balanced by the increasing rise in the whole product. A small share of a large cake may well be absolutely greater than a large share of a small cake. It can be shown that labour's share of the social cake will always increase, but not so fast as the cake itself. But under monopoly not only the effective but also the absolute

share of labour may diminish. With the development of monopolistic combines in all the main branches of industry (perhaps promoted by the State, as in the Coal Mining Bill, 1930), integrated into one vast monopoly by the banking and credit system, the whole level of production will be regulated so as to maximise the profits of the capitalist class. If the workers do not accommodate themselves to the reduced demand for labour, unemployment will result, the social dividend will be doubly lowered, firstly by the monopolistic action of employers, and secondly by the refusal of the workers to accept an "economic wage." Employment can only be found for the whole body of workers, and production can only reach the maximum possible under monopoly, if the workers accept the monopolist employers' demands for wage reductions. But, if wages are reduced, an expansion of production results, the total income of society increases, but that of the workers increases little, or even diminishes. (It is true that at the lower wage more men will be employed, but the more the machine is perfected the more inelastic the demand for labour is likely to become, and so the total sum spent on wages is likely to diminish rather than to increase.) Thus the workers' share diminishes and the capitalists' share gains. The same consequences follow from another train of reasoning. If labour costs are reduced under competition, the reduction is passed on to the consumer. He turns the purchasing

power so released to the purchase of other commodities (or possibly more of the same commodity). This extra demand creates a demand for more labour. Thus the workers displaced from their first occupation are employed to satisfy the demands of the same class of consumer. There is little transference of wealth between class and class. That is to say that the terms on which the displaced workmen will be re-engaged will be, in the long run, as favourable to workers as the old terms. But if the capitalist retains the saving of cost, consumers' demand is unaltered. There is, however, additional purchasing power in the hands of the capitalists. Workmen displaced can find employment in producing things demanded by capitalists. That is to say, there is a transference of command over wealth from workers to capitalists. This corresponds to the fact that the displaced workers can only find employment on terms which will be more favourable to employers than on the old terms. (This will also tend to depress the terms on which the non-displaced workers can retain their employment.)

We have seen, then, that under monopolistic capitalism full employment can only be guaranteed to the working class on condition that they accept a diminishing share (relative share, and possibly absolute share) of the goods they help to produce. That is to say, industrial progress will only be possible on condition that productive energy is continuously transferred from industries satisfying workers' demands

to industries satisfying capitalists' demands. But the question may well be asked, What sort of industries will these be? In what way can the capitalist class spend an increased proportion of an increasing total of wealth? The answer is twofold: firstly, by increasing their personal consumption; secondly, by investment. Many Socialists assert the impossibility of greatly increased personal consumption by the wealthy, but this is foolish. It is true that man does not want to wear two shirts at once, and to eat two dinners, etc., but he can easily wear an embroidered shirt that embodies ten times as much human effort as a plain one, or he can make a point of never wearing the same shirt again. He can eat a dinner that calls for the services of ten times as many men as would suffice to produce a simple but adequate meal. When the demand for luxury goods falls off, a great deal of labour can still be absorbed in personal service. It is worth remarking that during the years 1924–29 in the U.S.A., while the output per head in manufacturing industry rose steeply the number of men employed fell; employment increased in service occupations, such as restaurants, drug-stores, filling-stations, amusements, cleaning and pressing clothes, etc. It may well be that, if the capitalist system continues, social convention will impose upon the rich a more than Byzantine sumptuousness and display. Already one rich woman is almost obliged to spend on dress alone what would maintain ten working-class

families in comfort. There are unlimited possibilities of what Veblen calls "conspicuous waste." Besides, it must be remembered that the technical changes that diminish the need for common labour increase the need for the trained technical and commercial specialists, and for those who train them. We may thus expect to find a growing middle class of well-paid technicians, corporation lawyers, high-pressure salesmen, and university lecturers. The ranks of this class will be swelled by the parasites inevitably attendant upon a plutocracy—artists, writers, entertainers of all kinds, fashionable physicians, and *grandes cocottes.* This class, more numerous than the plutocracy itself, will, if it attains the standard of life of the prosperous American business man, create a considerable demand for labour. The other possible outlet for the spending power of the plutocracy is investment. The purchase of production goods creates as much demand for labour as the purchase of consumption goods. But in what branches of industry will investment be profitable ? The very nature of monopolistic capitalism restricts the possible field. Obviously there will be but small opportunity of profitable investment in industries that produce goods consumed by the working class. There will be scope for investment in industries producing goods and services consumed by the plutocracy itself and its parasites. But the possibilities of profitable investment within the closed system of monopolistic capitalism are limited. If investment is to

continue without scaling the rate of interest disastrously down, it must take the form of the export of capital. Railway building and industrial development in China would keep the system going for another generation. Since the parts of the world not yet parcelled out among the spheres of interest of capitalistic powers are few, an intensification in the urge of capital to export itself is likely to lead to more acute international rivalries. This in turn will produce an increased demand for armaments, which will absorb quite a lot of surplus purchasing power, and so to war.

THE EVOLUTION OF JOINT STOCK ENTERPRISE

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THE EVOLUTION OF JOINT STOCK ENTERPRISE

THE MODERN CAPITALIST AGE is the age of joint stock enterprise, and its outstanding achievement in economic organisation is the joint stock company. Wherever capitalism appears and develops, the joint stock system develops with it. There are differences in the company laws of the various capitalist States, and some of these differences are important. But everywhere the essential institutions, by whatever names they may be called and however they may differ in secondary characteristics, are fundamentally the same. The joint stock company, or corporation, is as central and representative an institution of the capitalist world as the craft or merchant gild was of the medieval economic system.

Yet capitalism did not invent the joint stock form. There were enterprises which possessed the character of joint stock concerns long before modern capitalism was born. The joint stock company, moreover, was a familiar and well-established institution long before the advent of modern power-production made it indispensable for the conduct of ordinary industrial undertakings. It was legally recognised, and in certain cases politically influential in a high degree, long

before what is called the Industrial Revolution. The East India Company and, later, the Bank of England were great political as well as economic powers long before Watt improved the steam engine, or the great sequence of inventions occurred in the metal and textile trades. But joint stock concerns, though powerful and well recognised, were not the typical form of economic organisation in the seventeenth and eighteenth centuries, or even in the early decades of the nineteenth century. Adam Smith's dictum about them, with its exceedingly narrow definition of the purposes to which they were appropriate, has been quoted again and again; and McCulloch, Ricardo's foremost populariser, could repeat Adam Smith's judgment practically unchanged half a century after the publication of *The Wealth of Nations*. Even Marx, in 1867, largely missed, in the first volume of *Das Kapital*, the significance of joint stock enterprise as an instrument of economic evolution, though he was well aware of the economic forces which were responsible for its growth. Only in the latter half of the nineteenth century did the joint stock company come thoroughly into its kingdom, and begin to reveal to the full its flexibility as a form of economic organisation, and its influence on the class-structure of the capitalist system.

These are the two aspects of the joint stock system which this essay sets out above all to stress—its flexibility, and its influence on class-relationships. For

it is in these two things that its fundamental significance appears ; and these, more than any other of its qualities, are the clues to the understanding of its place in the world of to-day and to the consideration of its future. They have enabled it to adapt itself to the vast changes which have taken place in the underlying technical conditions of capitalist production during the past fifty years, to make part of itself the phase of economic imperialism upon which capitalism has entered, and above all to counteract the tendency for the large capitalist to eat up his smaller rivals by broadening the basis of capitalist ownership, and giving to capitalism itself a bastard democratic form which has safeguarded it against the onslaughts of nineteenth-century political democracy.

The rise of joint stock enterprise explains the great paradox of modern capitalism—its combination of an extreme individualist theory with a no less extreme corporative practice. The hero of the capitalist romances—miscalled textbooks of economic theory—has been the dauntless individual man of business, given free scope for his spirit of enterprise in a world of economic liberalism. The capitalist—the abstinent man who was not merely abstinent, but also the supreme director of his own personal business of buying and selling, getting things made, adding at once to his own wealth and to mankind's—he, in all his individual glory, was the final justification of the capitalist system. The economists, and still more the

tractarians who popularised their doctrines for the edification of the masses, sang above all his praises, and reposed in him their hopes of human progress. And yet—their Pindaric odes were hardly out of their mouths when one by one their heroes, by the simple device of writing "and Co.," and then "and Co., Ltd." at the end of their names, were metamorphosed into abstract beings, and became capable of surviving mere bodily death. Singular became plural; individual turned into association: yet in such a way that the individual remained, and the hero of business romance could wield his battle-axe not merely with the strength of ten, but with the sucked-up vitality of ten thousand shareholders.

For capitalism, in becoming collective, did not give up its individualism. This did, however, take on new forms, appropriate to the changing conditions. The earlier capitalist exemplified in his own individual person the twin virtues of enterprise and abstinence. He forwent the amenities of life not only in order to put back every available penny of profit into the business, but also in order to slog away personally at making it a success. In the economic theory of this period the distinction, now familiar, between interest and profits, even if it was realised, was stressed hardly at all. Naturally; for the typical capitalist was entitled to both—to profit as the reward of enterprise, and to interest as the reward of abstinence. Why mind the difference, if both accrued to the same benefactor?

The emergence in economic theory of the stress on the difference between profits and interest coincides with the division of the capitalist person. The "man of enterprise" survives, as the first creative agent of capitalist production ; but at his side, feeding him with indispensable supplies of capital, is his faithful friend, the "man of abstinence," who, by putting aside and investing a part of his income, enables production to develop even if he takes no personal part in its direction. It is a moot point at this stage which of the two is "the capitalist" *par excellence* : in effect they are the two kings of an undivided kingdom. For, if the man of enterprise cannot be enterprising without capital, neither can the capital be fertilised for its possessors save with the aid of his ingenuity and drive. That is the theory of modern capitalism in its middle phase of development.

But, as time goes on, the system does not stand still. The investors, becoming a more and more numerous class, loom larger and larger : the man of enterprise, on the other hand, loses stature as the scale of organisation grows, and the actual business of controlling large enterprises has perforce to be functionalised and divided between a number of co-operating individuals. It looks as if the investor, who provides the money, is destined to become all-important, and the man of enterprise, no longer able to exercise a purely personal control, to be reduced to the status of manservant to the corporate body of investors.

This, however, cannot happen ; for the investor too is changing his nature. Less and less does he stake his fortunes on partnership with a particular man of enterprise, or even in a particular concern. Aided by the device of the easily transferable share of small denomination, he takes more and more to spreading his risks, by scattering his savings among a host of different productive or trading enterprises. He is involved lightly in many businesses, deeply in none. Or, if he does not adopt this device of spreading his risks for himself, special agencies arise to do it for him. Insurance companies, investment trusts, and other typical institutions of modern " broad-bottomed " capitalism mediate between the " saver " and the productive use of his money.

" Spreading," great as are its virtues from the standpoint of the individual investor, destroys collectively the investors' power. For it means that the vast majority of those who invest their money in capitalist concerns have neither time, nor ability, nor inclination to regard these concerns in any other light than as mere agencies for the production of surplus value. Shares and bonds in industrial enterprises come to be mere certificates of claims to receive dividends or interest, saleable at a stock market value varying with business conditions and with the anticipated fortunes of each particular enterprise. Their owners, entitled to attend the company meetings and thereby with their votes to appoint the directors to administer the

businesses, ceased in most cases even to consider the possibility of attendance, or to regard themselves as in any way responsible for the conduct of the enterprises which were legally their property. This was natural and inevitable ; for what collective influence could possibly be exercised by a constantly shifting body of shareholders, scattered far and wide, unknown one to another, and for the most part utterly ignorant of the conditions of the industry or the business in which their money was embarked ? They bought and sold, in their own minds, not a share in the ownership and responsibility of a shipyard, or a steelworks, or a chemical factory, but a claim to receive income, which might turn out well or ill. Occasionally, a scandal or a scare attaching to a particular company may attract a large attendance at a shareholders' meeting ; but as a rule the great majority of shareholders no more think of attending than an atheist thinks of going to church.

In these circumstances, while the support of those who have money to invest remains the indispensable basis of the system of capitalist production, those who provide the money for the most part cease utterly to count, in relation to any particular business, as soon as they have made payment for their shares. Modern capitalism does not become democratic with the growth of the investing public, even to the extent to which democracy is compatible with a system which accords votes to shares and not to men. It does not

become democratic, even to the extent to which a select vestry, with cumulative voting, can be regarded as an embryonically democratic institution. Its legal "parliamentarism," its paper basis of representative government, is in reality a sham. It has no tendency, such as exists in political representation, to develop towards democracy, in the sense of a real evolution towards universal suffrage.

But, if the suppliers of capital fail to take effective control of capitalism, the individual man of enterprise also suffers a metamorphosis of his own. As we have seen, the growth in the scale of business and the increasing technical complexity of the processes of production combine to split up the actual management of industrial enterprises more and more among a number of specialists. The "employer" of the early nineteenth century was thought of—though he was not always so in fact—as the personal controller of a productive business, in which he gave all the orders and had practically the sole responsibility, with only workmen, supervised by foremen who were little more than workmen, to carry out his orders. But this situation could not last: it was more and more altered, in two distinct and yet related ways. At one end of the scale, the individual employer began to turn into a co-operating group of working directors; and at the other the hired "labour" force began to include a rapidly growing number of technical specialists, managers, financial experts, buyers and agents, whose

status and remuneration were far above those of the manual workers and the workshop foremen and supervisors. In some of the largest-scale enterprises—for example, on the railways and in certain types of public utility undertaking—the " man of enterprise," administering the business for his own profit, absolutely disappeared, leaving behind him on the one hand almost functionless directors who did not direct, and on the other general managers and other high officials who conducted the business as salaried employees. This latter evolution, towards control by salaried employees, went even further in Germany than in England ; for in Germany it was aided by the adoption of a somewhat peculiar form of joint stock structure.

Thus the " man of enterprise," as he was conceived by the early apologists of capitalism, was resolved by capitalist development into a number of separate elements. This disintegration of the original entrepreneur went stage by stage with the evolution of the joint stock system, which caused production to be more and more set on foot and regulated not by individuals acting by themselves but through large-scale organisations, in which decisions were reached by the joint cerebrations of a number of different persons, each acting and thinking not merely as an individual, but as a member of a co-operating group.

It would nevertheless be quite misleading to suggest that, as a consequence of this evolution, the individual

entrepreneur has disappeared, or exists only as a survival in those sections of the business world where small-scale enterprise is able to maintain its existence. On the contrary, under the modern joint stock system the individual man of enterprise has been reborn, but in a new guise. He reappears in the joint stock system of to-day, not primarily as an employer or organiser and director of the productive process, but as a financier, concerned chiefly with the manipulation of capital assets, and only in a secondary sense with the production of goods and services.

For, though the form of joint stock enterprise is essentially associative, the joint stock company or corporation is in fact often an association only in form, and becomes, the more readily because of the apathy and ignorance of its members, the instrument through which a powerful individual can exercise financial control. One man may dominate many companies—may indeed throw off new ones with the fertility of a spawning fish—giving to each the shape and outward seeming of an association, while he is in fact absolute master of their destinies. Or he may buy up controlling interests, and interlock company with company by complicated shareholding arrangements, until the resulting tangle at once invites and defies graphical presentation.

Such instances are spectacular; and journalists love to tell of the "mystery men" of modern high business who control countless millions, and fling out joint

stock companies over the globe as a sower sows seed. Certain types of business lend themselves especially to this type of personal domination—oil, armaments, and above all merchant banking in the broadest sense. But even this sort of enterprise usually turns associative, at any rate in the second generation ; for with the passing of the great man his power falls most often not to a single successor, but to a co-operating group of lesser giants. Nevertheless, huge authority continues to be concentrated in the hands of a very few men, who wield together virtually absolute control over many more millions of pounds or dollars than they possess ; for there never was a device so favourable as joint stock to the getting of control by the richer capitalists over the capital of their poorer brethren. A company may have many thousands of shareholders, and yet be no more than one link in a chain of which the ends are securely held by one man, or by a tiny group.

The vital point, however, is that the control which is exercised in this way is often almost purely financial in its nature. If, at one end of the joint stock system, the general body of shareholders are interested in the concerns they chiefly own only as producers of income, and not at all as producers of goods, almost the same thing may be said, at the other end, of the master spirits of the business world. They too regard businesses as instruments for the making of money, by way of dividends or of capital appreciation, far more than as

embodiments of a part of the community's power to produce the useful things on which money is to be spent. The concern with actual production passes from entrepreneurs on the one hand and investors on the other to an intermediate class of salaried managers and technicians, or subordinate directors of main or subsidiary companies, who are often simply the servants and executants of the few who really control high policy.

That this is often bad for the community of consumers, bad for the body of employed workers, and bad for the general mass of investors, has often been pointed out. For to regard productive agents merely as instruments for the realisation of money-values often results in dangerous distortions of view and policy. It lends itself to the ruthless shutting down of competitive undertakings, without regard to the social or wider economic consequences of such a policy. It may result in the concerted limitation of production, and holding up of prices, at the consumers' expense. And it often leads to the rigging and manipulation of the stock market values of securities in ways which hit the inexpert mass of investors hard. For in the ceaseless buying and selling of stocks and shares, and above all in the flotation and disposal of new capital issues, the insiders are obviously at an enormous advantage over the general investing public, which knows far less than it could know if it tried, but cannot in any case know nearly enough to place itself on a footing of

equality with the giants, however hard it may try.

We have, then, a system of capitalism which has placed by far the greater part of the major industries upon a joint stock basis, so that the legal ownership of the plants belonging to them is widely—and coming to be more and more widely—diffused, the management of the actual productive processes largely in the hands of salaried subordinates, and the control of high policy more and more concentrated in the hands of a small number of men, who are far more financiers than industrialists—far more manipulators of monetary values than organisers of the production of goods and services. This is the underlying character of the joint stock system as it is to-day; and we have now to examine more closely the ways in which this remarkable result has come about.

It is common knowledge that in the eighteenth and early nineteenth centuries the joint stock form of organisation was regarded with a large amount of mistrust, not only by economists such as Adam Smith and McCulloch, but also by politicians and by business men. The South Sea Bubble, and other incidents of a similar kind, had given joint stock projects a bad name; and from 1725 they had been definitely restrained by law. This did not prevent absolutely the creation of new joint stock enterprises, nor did it of course affect the position of such existing recognised institutions as the East India Company and the Bank of England. But it did mean that for a whole century

of rapid capitalist development no new joint stock concern could secure the recognition of the law unless it was brought into being and obtained its authority by a special Act of Parliament—a procedure possible only in rare instances and adopted in practice only in the case of a limited range of public utility undertakings. Apart from such special creations by Act of Parliament, joint stock enterprises could be, and were often, formed in fact; but in the eyes of the law they had no corporate existence, and were mere partnerships of a number of individuals trading in co-operation.

This want of legal status had very serious practical disadvantages. It is the privilege of every modern joint stock company to be recognised at law as an incorporated body distinct from the members composing it, so that the company itself can sue or be sued in a court of law, and take action as a company in any matter which falls within the scope of its authorised activities. This valuable privilege lies, of course, at the root of the entire recognition of the limited liability of the shareholders; for, as long as the company was regarded by the law as merely a number of individuals acting in partnership, each individual, even if he held but a tiny fractional share in the company's property, was bound to be personally liable without limit for its debts. The recognition of the limited liability of the shareholders followed logically upon the recognition of the company itself

as possessing a distinct legal personality, so as to be itself an owner of property distinct from that of its members. The history of the evolution of the modern joint stock system is bound up with the gradual admission by Parliament and the courts of law of the legal personality of companies, which had previously been regarded as mere trading partnerships of individuals.

There were other grave disadvantages in the position of the unrecognised companies which the needs of the economic situation brought into being in advance of the development of modern company law. For it was highly inconvenient to have to treat a company as merely a number of individuals acting together whenever the number became considerable and subject to constant change through the transference of shares from one ownership to another. In the course of a legal action brought against the individuals comprising the company, the ownership of shares might alter, thus offering occasion for all manner of legal quibbles about whether a bill had been rightly drawn. Actions had sometimes to be dropped and started all over again because of such changes; and the legal collection of debts from an unrecognised company was always a perilous, and apt to be an extremely expensive, business, far more profitable to lawyers than to anybody else. As the development of the new industrialism more and more compelled businesses to adopt a joint stock structure, and to

appeal to a wider body of shareholders to supply the larger masses of capital which they required, the absence of legal recognition and of corporate personality became more and more inconvenient. It was a strong deterrent against having a numerous body of shareholders, and against a shareholder embarking his money in any concern of whose success he did not feel sufficiently confident to be ready to assume an unlimited risk. It put obstacles in the way of the division of shares into units of small denomination, and of their transference from one ownership to another. In fact, in the early years of the nineteenth century the legal status of joint stock companies came to be so much out of harmony with the needs of the economic system as to put serious barriers in the way of economic development.

Something was done in practice by the courts to mitigate the severities of the complete refusal to recognise any joint stock body not expressly authorised by statute. Gradually, by stages which there is no space to describe in this essay, the now familiar device of the " representative action " was developed, and companies were enabled to appear in the courts in the persons, not of the entire body of their shareholders, but of representative individuals selected as standing for the whole number of co-partners. But the courts for a long time admitted this type of action only with extreme reluctance, and subject to many qualifications. Indeed, the " representative action "

obtained the degree of recognition which it has now, in relation to all manner of unincorporated associations, from golf clubs to philanthropic and propagandist societies, only after the corporate existence of such bodies as joint stock companies and co-operative societies had been fully admitted by statute, and as a reflection of changes in statute law more than as a spontaneous modification of common law doctrine.

Doubtless, full legal recognition of the joint stock system would have been forced sooner by economic pressure had it not been for the possibility, in exceptional cases, of large-scale enterprises securing recognition by getting a special statute through Parliament. For this method could be, and was, used where the need for a wide basis of shareholding and the recognition of limited liability was most urgent. In a sense, the effective pioneers of the modern joint stock system were less the old statutory companies, such as the East India and South Sea Companies, than the bodies of commissioners who were set up in the eighteenth century to make and administer river improvements, and the Turnpike Trusts through which a more adequate system of roads was being gradually evolved. For road and river provided the model for the definitely joint stock organisations which undertook, in the latter half of the eighteenth century, the building of the canals ; and the canal companies in turn passed on their structural form to the railways, which above all prepared the way, in the first half of

the nineteenth century, for the general recognition of the joint stock form of industrial enterprise. Public utility undertakings, such as gas companies and water companies, also contributed, from the beginning of the century, their quota to the growth of the new system ; and a further influence making in the same direction came with the rapid development of insurance. Moreover, repeated crops of bank failures, especially among the smaller country banks, made men see the necessity for giving a broader financial basis to the system of deposit banking ; and, rather later than insurance, banking began to pass over to a joint stock system, and the monopolistic position of the Bank of England, as the only English joint stock bank, disappeared, leaving it free to develop for itself a new status as a Central Bank concerned with the note-issue and the conduct of Government business, and with serving as a " bankers' bank " and as a " lender of last resort."

All the earlier developments in the field of transport and the public utility services, which were thus vital to the growth of the joint stock system, were made by the passing of special Acts of Parliament, each conferring status and powers upon a particular company. This was, indeed, the only method available in the first quarter of the nineteenth century ; but there was also a special reason for it—one which has caused railways and gas, water and electricity companies ; indeed most public utility undertakings—to retain up

to the present time the special form of statutory, or parliamentary, companies, with a status differing from that of the companies responsible for ordinary industrial undertakings. This reason is that railways, canals, gas and water companies, and similar public utilities, almost all need special powers—the right compulsorily to acquire land, to dig up the public streets, to exercise a monopoly of supplying a particular service within a defined area. These and similar powers can be acquired only by statute ; and it is still necessary in most cases for any body which needs powers of this sort to get them specially conferred upon it by name by means of a distinct Act of Parliament—though in certain limited cases Government departments have now been granted authority to confer such powers by a simpler and less expensive procedure. A railway company or an electricity undertaking is still not a company incorporated under the Companies Acts, but the creature of a special statute of its own.

As the number of bodies applying for such special statutes increased, in the first half of the nineteenth century, it was gradually seen to be desirable to simplify the methods by which they could receive the necessary powers. A precedent was found in the General Inclosure Acts which had been passed in 1801 and later to lay down standard provisions which could be incorporated by reference into any special statute providing for the enclosure of a particular area of land.

On this useful precedent were based the Clauses Acts of 1847 and subsequent years—the Gaswork Clauses Act, the Waterworks Clauses Act, and so on, embodying standard clauses which could be incorporated by reference in the Acts dealing with particular undertakings.

This method of securing incorporation by special Act of Parliament was, however, available only in the case of undertakings falling within the sphere of recognised public utility services. Parliament would certainly never have agreed to grant the privilege of incorporation by special Act to an ordinary trading or manufacturing concern; nor would it have been possible for most concerns engaged in trading or manufacturing processes to incur the heavy expenses involved in the promotion of a private Bill. But the same conditions as compelled the legislature to recognise the necessity for joint stock organisation of the public utility services were coming in the first half of the nineteenth century to apply to an increasing number of manufacturing concerns as well. It is true that the pressure for incorporation was much less in this case than in the transport and other public utility services; for the typical industrial firm of the Industrial Revolution remained small, and its conduct by an unincorporated body of shareholders or partners was by no means out of the question. Nevertheless the accumulating inconveniences of the unincorporated "company" did cause by the second quarter of

the nineteenth century a growing demand for some sort of legal recognition of the company form in these cases as well. As we have seen, the Bubble Act, which prohibited the formation of joint stock companies, was repealed in 1825; but it was not until ten years later that anything was done to legalise the position of the numerous companies which were actually in operation. In 1834 the legislature took the first step towards the formal recognition of joint stock concerns on a wider basis by general Act of Parliament. In that year Parliament passed an Act enabling the Crown by Letters Patent to grant to unincorporated companies the right to sue and to be sued under certain restrictive conditions. But Letters Patent were not easy to secure, nor were the privileges granted under the Act of 1834 very extensive. Consequently ten years later a further Act was passed under which it became possible for companies which were in fact joint stock concerns to obtain a certificate of incorporation without either a special Act of Parliament or a grant of Letters Patent by the Crown. This Act of 1844 represents the real beginning of the general recognition of the joint stock system as indispensable for the conduct of ordinary types of business. It recognised all joint stock companies which registered under it as incorporated bodies, and thereby gave them a definite status in the eyes of the law. Further amended three years later, this Act remained for the next decade the basis of the law relating to joint stock

companies; and a large number of companies took advantage of the privileges of registration, and many new companies were formed during this period.

The most vital privilege which is associated with the modern stock system was, however, still withheld by the legislature under the Acts of 1844 and 1847. In the modern world the typical joint stock company is above all else a limited company, that is to say, its incorporation takes place on terms which carry with it the privilege of the limited liability of its shareholders. It had always been possible for a company formed by special Act of Parliament to obtain this privilege of limited liability by the terms of its own Act, and it had been recognised as necessary to grant limited liability in the case of those large concerns which needed to raise their capital from a very numerous body of shareholders, who could not be expected to be willing to incur an unlimited liability in connection with their relatively small investment. Railway development, for example, would have been utterly impossible on anything like the required scale unless the railway investors had received the protection of limited liability. It was, however, for a long time held that this privilege should be granted only in the most exceptional cases, and that it would be a positive temptation to dishonesty to confer it upon ordinary trading enterprises. For the ordinary trading enterprise was still regarded as in its essence rather a partnership of a number of individuals actively

engaged in the business than as a fully corporate body whose existence and policy could be clearly distinguished from those of the individuals who owned its shares. It was widely said that to grant limited liability to the general run of businesses would be to invite the formation of bogus concerns and to provide unnecessary opportunities for the swindling of the suppliers of materials and machinery by unscrupulous individuals. It was argued that if a man or group of men undertook the risks of business they ought to be prepared to meet these risks with their whole fortunes, and that the State ought not to intervene so as to relieve them of any part of their liability. Before one parliamentary inquiry or commission after another this question was argued out. It was not until 1855 that Parliament was at last convinced that the growth in the scale of productive enterprise made inevitable the extension from the transport and public utility services to ordinary productive businesses of the full rights of incorporation, including the limited liability of shareholders. The Act of 1855 at length granted this right, and as amended and consolidated in the better known Act of 1862, it became the foundation of modern company law. Limited liability was at length open to all business firms that cared to apply for it, and the way was thus made open for a tremendous extension not only of the sphere of joint stock enterprise, but therewith of the possible field of investment offered to possessors of capital in either large or small

amounts. The granting of limited liability undoubtedly broadened very greatly the basis of capitalist investment, and of capitalism itself. It is more responsible than any other single measure for the enormous growth of the investing middle class in the latter half of the nineteenth century.

The Act of 1855 was not followed by any immediate rush to form new companies. It took some years for the scope and character of the new privileges to become widely known, and it was not until the early 'sixties that the really rapid extension of the joint stock system began. But thereafter there was an extraordinarily rapid advance. At that time no tax was laid upon the authorised or issued capital of companies, and accordingly firms were free to announce an authorised capitalisation of any amount they might choose without incurring any penalties. Only in 1891 was the system of taxing authorised capital issues introduced, with the effect of deterring projectors from announcing the formation of companies with a far larger capital than they had any hope of raising or even any means of employing. This to some extent falsifies the figures showing the number and capitalisation of companies formed during the period immediately after the Act of 1862. In 1869, for example, the figures are completely distorted by the formation of a company with a nominal capital of £100,000,000, of which only £200 was actually subscribed. Only from 1891 do the figures come adequately to reflect

the real amounts of capital which were being invested each year under the joint stock system.

I do not propose to follow out here the subsequent history of the legislation dealing with joint stock companies through all the many amendments which have been made since 1862. It suffices to draw attention to a very few outstanding features of the joint stock company system as it has developed during the past seventy years. The original intention of those who passed the Acts of 1855 and 1862 was undoubtedly that the joint stock system, in its extension over all types of industries and services, should still be confined to those undertakings which by virtue of their magnitude needed to enlist the services of so large a body of shareholders as to make their conduct without incorporation both difficult and inconvenient for those who had dealings with them. But in fact, when once the privilege had been granted, it was impossible to confine it within these limits, for there was nothing to stop any small body of persons who wished to secure the protection of limited liability and to trade under a recognised collective name from registering their concern as a company if they were prepared to pay the necessary small fees and expenses. For some time this was regarded as an infraction of the spirit, though not of the letter, of the Companies Acts, and especially what were called "one man companies" were regarded with public disfavour—"one man companies" being those concerns in which one man really

owned the business, but associated with himself six dummy shareholders, holding perhaps one share each, in order to make up the minimum of seven shareholders required by the law. Nevertheless, the number of "one man companies," as well as of small concerns which assumed the company form, continued to increase, and finally in 1907 Parliament definitely registered a change of view by including in the Companies Act of that year (and in the Consolidating Act of 1908) a clause which explicitly recognised the right to form small companies with a limited number of shareholders. These small companies were henceforth to be distinguished from the general run of companies under the Acts by the name of "private companies," and they were given certain privileges as against "public companies," in that they were not required to file their balance-sheets for inspection at Somerset House, but only their lists of shareholders together with their Memorandum and Articles of Association. In return for this privilege, which has turned out to be of great economic importance, the private company is not permitted to have more than fifty shareholders or to make any appeal to the public to subscribe to its shares. It must, moreover, restrict the transfer of its shares in order to enable it to comply with the provision that the number of its shareholders must not exceed fifty. For if its shares were able to change hands freely it could have no control over the number of separate hands into which they might pass.

This creation of the private company as a distinct form turned out, like so many things in the evolution of company law, very differently from the intentions of those who enacted it. It had been meant as a special privilege, to be given to a quite limited range of small concerns; but in fact it opened the door wide to the creation of a number of quite new types of joint stock concern. In the first place it became far easier for private businesses, from small manufacturing concerns to the shops of retail traders, and also for individuals engaged in a wide variety of economic operations, to secure the privilege of limited liability by turning themselves into companies. Not only the family business—say a small textile mill or boot factory—and the substantial grocery or other retail store, but also in certain cases the large landowner as an individual, became a private company, and thus both limited the risks involved in the type of business which he carried on and secured easier conditions for charging up expenses against income for purposes of taxation. Moreover, the joint stock form of organisation made it easier, especially in the case of family businesses, for the owner, when he died, to leave shares in the business to different relatives or friends without involving any forced sale of assets in order to pay off the legatees. For these reasons the private company system, introduced first in 1907, became more and more popular with types of business which had previously been carried on without the privilege of incorporation.

This, however, was not the only, or even the most important, consequence of the recognition of the private company by the Act of 1907. The second great consequence of this step was to promote the growth of what are called "subsidiary companies." It had of course been possible under the old system for a number of companies, each nominally independent of the others, to be linked together by a system of interlocking directorates or exchange of shares, or by the common ownership of a large part of their respective capitals. But the separate recognition of the private company made it very much easier to form large business units consisting of a number of distinct undertakings, each of which had legally the form of an independent company. Thus a big productive business, instead of starting new works or establishing agencies in new markets directly under its own auspices, could create for this purpose a number of separate private companies, in each of which the parent business held either the whole of the shares or at the least a dominating interest; or again two or more large concerns could join together in creating a private company under their joint ownership for the exploitation of a particular source of raw material or for the conduct of a subsidiary process. If the business connections of almost any great concern are examined to-day, it will be found that the parent company, however constituted, has grouped round it a considerable number of subsidiary enterprises in the form of

private companies. Indeed, in some cases this process has gone so far that the parent company has ceased to do business at all, and exists merely as a holding company in which are vested the shares and the ultimate control of the subsidiary companies, the whole business of producing and selling the products of the concern being carried on under the auspices of these subsidiaries and not of the parent body.

Where any joint stock company which is itself registered as a public company carries on the whole or a part of its business under the auspices of subsidiary private companies, the effect still is, in spite of recent legislation, largely to defeat the objects of the Companies Acts in respect of publicity. Until the amending Act of 1928 there was no obligation upon any parent or holding company to disclose any material particulars with regard to its subsidiary undertakings. Any sums received by way of dividend from such undertakings had of course to appear in the balance-sheets of the parent concern. But there was no need to chronicle the losses or appropriations to reserve account of subsidiaries, or to give any account of their operations to the shareholders of the parent company, or to publish changes in the capital value of the parent's investments in its subsidiaries. Thus the balance-sheet of the parent or holding company did not need to give any true picture of the position of the subsidiaries; and the investor who bought shares in the parent concern had no means of discovering whether the

particulars disclosed in the published balance-sheet accurately reflected the economic position of the complete undertaking or not. Even now the amended law only compels disclosure of the general economic position of all the subsidiaries of the parent company taken together, and does not require any disclosure of the position of any individual subsidiary company: so that, although the requirements of the law are somewhat more stringent than they were prior to the Act of 1928, they still fall far short of ensuring to the investor any adequate understanding of the real economic value of the assets which he holds. This, indeed, could not be secured unless private companies were subjected to the same conditions as public companies in respect of the publication of audited balance-sheets, disclosing both their current profit and loss, and the balance-sheet position of the undertakings from the capital point of view.

To this, however, there would certainly be very strong opposition from the interests chiefly concerned. The ordinary private company which is not a subsidiary of any public company values greatly the privilege, which it shares with unincorporated partnerships and private businesses, of not being compelled to disclose its financial position, and any attempt to impose upon it the obligations which apply to public companies would be certain to be strongly resisted. On the other hand, it would be very difficult to impose effectively the obligation to publish audited

balance-sheets only on such private companies as are subsidiaries of public companies. For it is not easy to define what is a subsidiary and what is not. The law at present attempts to meet the difficulty by imposing the obligation of publicity not on the private company as such, but on the public company in respect of its grouped subsidiaries, and the most likely line of amendment would be to carry this obligation further by increasing the amount of information which a public company is compelled to give about those concerns in which it holds investments. There are further considerable legal difficulties in the way of this, as it is not easy to impose upon a public company the obligation to disclose with regard to a separate company particulars which the separate company itself cannot be required by law to disclose. In fact the company form has developed in Great Britain in such a way as to withhold from the investing public information which is indispensable if stock exchange values are to be based on a knowledge of company affairs which is available equally to all investors who take the trouble to look for it, and not as at present largely on "private information," which may be either accurate knowledge confined to a comparatively narrow range of persons, or inspired rumour deliberately spread in order to influence the stock exchange value of a particular security—or of course anything between these two extremes.

This lack of adequate information about the actual

economic working of the company system tends still further to reduce the ordinary investor to a mere blind follower of market quotations, interested in the shares which he buys and sells only from the standpoint of their stock market appreciation or depreciation. It is not only that, on account of the policy of spreading his risks, he is not in a position to acquire any real knowledge of the working of the businesses in which he invests his money ; it is also that even if he were to set out deliberately to acquire this knowledge he would find in most cases insuperable obstacles in his way. The great majority of investors have long ago given up any attempt to understand the economic position of the companies of which they are part owners, or to take any interest in their affairs from a technical point of view. They are mere buyers and sellers of stock market values, to whom it is utterly indifferent in what commodities or forms of production the companies in which their money is placed are engaged or in what manner their capital is employed.

A further effect of the great extension of the company system in recent years has been to increase the amount of capital over which the large investor is able to gain effective control. For if the money which is invested in one undertaking can be reinvested by this undertaking in others it can also in this process attract to itself additional capital, over which the owner of the original investment can exert practically

unfettered control. Let us assume that in Company A a certain investor or group of investors holds 51 per cent of the shares, thereby controlling almost twice as much money as he or they actually possess. Now let us suppose that Company A reinvests the greater part of this money in Companies B, C, and D, associating in each case with their investment a certain amount of money belonging to other persons, but always so as to leave themselves with at least 51 per cent of the shares in each of these companies. By the time this process is complete, the total amount of money held by the owners of the 51 per cent interest in Company A is far more than twice the amount of their actual investment, for they have brought under their control not only the 49 per cent of the capital of Company A, but also anything up to 49 per cent of the capitals invested in Companies B, C, and D.

Nor is this by any means the whole story; for in order to control a company it is by no means necessary to own 51 per cent of its total capital. In the first place, the owner of a large concentrated block of shares usually finds himself confronted not by a united body of other shareholders capable of common action, but by a number of scattered individuals who are most unlikely to attempt to interfere in a concerted way with the operation of the company. In practice a 30 per cent holding may be quite enough to ensure absolute control if the remainder of the shares are sufficiently widely diffused in the hands of other

investors. Moreover all capital subscribed for use in the operations of a company need not rank equally for purposes of control. Debenture holders, who are not directly owners of capital at all, but creditors of the company, can exercise no control over its operations as long as their interest is punctually met. But in addition to this, it is a common practice to disqualify preference shareholders from exercising any voting rights, at any rate as long as their preference dividends are being regularly paid. And, even when preference shareholders are given some voting rights, these do not necessarily or in most cases correspond to the amount of money which they have invested. Thus it is not unusual to have a larger denomination for the preference than for the ordinary shares, so that each preference shareholder gets one vote for each share of, say, £1 or £5, whereas each ordinary shareholder gets a vote for each ordinary share of £1 or five shillings, or even one shilling. Nor is this usually resented by the preference shareholders, who have grown to value so little the privilege of control which shareholding theoretically carries with it as to be not at all reluctant to give it up.

The growth of the preference share registers, indeed, a significant change in the realities of capital investment. The preference shareholder, unlike the debenture-holder, is a part-owner and not a creditor of the business in which his money is invested. He does take upon himself a part of the risks of the

undertaking; and he cannot, like the debenture-holder, claim to receive his interest whether a profit is being made or not, or to foreclose upon the company if it fails to pay him his preferential dividend. His dividend can be paid, save in very exceptional cases in the first years of a company's operations, only out of profits actually made. But in order to make surer of receiving his dividend he accepts a limitation upon its amount in return for a first claim upon such profits as the company does succeed in making. If profits are made, the preference shareholders have to receive their 5 or 6 per cent, or whatever it may be, before the ordinary shareholders can get any return on their investments. But there, in the case of most preference shares, the return to the preference shareholder ends. However much profit the company may make, he gets nothing beyond his 5 or 6 per cent, whereas the claim of the ordinary shareholders is of course unlimited. There is, indeed, an intermediate class of share, the participating preference share, in which the preference shareholder comes in again with a further claim after the ordinary shareholders have received dividend up to a certain level, say, 10 per cent. But for the purposes of our present analysis, we can ignore this complication, and treat the preference share as typically a share which offers only a limited maximum return to the investor.

Naturally, shares of this type tend on the whole to appeal to a somewhat different class of investors from

ordinary shares ; and the growth of preference share-holding is closely bound up with the widening of the investment market in recent decades. As an increasing amount of the capital for business has come to be raised from small investors, who cannot afford to take large risks, and want a reasonably secure return on their money rather than a gambling chance of high profits, it has become necessary for businesses to devise a type of share which will suit their requirements. Their needs might doubtless have been met by an increase in the amount of debentures, but there are strong reasons why this would not suit the business world. For debentures, unless they are limited in amount in relation to the share capital of an undertaking, inevitably interfere with its credit.

Anyone who lets a company which has a large number of debentures have credit on ordinary trade terms does so at his peril ; for he knows that if things go wrong the claim of the debenture-holders will rank in advance of his own. The amount outstanding in debentures must then, if a business is to be soundly financed, be kept within reasonably narrow limits in relation to the entire capital of the undertaking ; and for this reason it is not open to the promoters of business enterprises to meet the needs of the small shareholders by an extension of the debenture system. This is the reason for the spread of the preference share, which resembles the debenture in that its claim precedes the claim of the ordinary share, but is

sharply contrasted with the debenture in that it confers no rights of foreclosure, and that its claim, being exclusively a claim to a share in realised profits, comes after the claims of business creditors of all kinds.

Of course it is not suggested that preference shares are always more secure than ordinary shares, or debentures always more secure than preference shares. An ordinary share in a thoroughly solid undertaking may be a far safer investment than a preference share or debenture in an undertaking of more doubtful status. But within the same undertaking the debenture obviously stands first in point of safety, the preference share next, and the ordinary share last ; and it is clear as a social phenomenon that the preference share has advanced in popularity side by side with the growth of the class of comparatively small investors who are unwilling or unable to assume the full risks of ordinary business enterprise.

The growth of the class of small investors is of course a highly important social and economic phenomenon ; and this diffusion of the ownership of the capital of industry is often pointed to as a sign of the growing "democratisation" of the capitalist system. Socialists are told that their denunciations of the capitalist class are not only unjustifiable but also obsolete, in view of the gradual extension of the investing public to cover a wider and wider section of the population. Stress is laid on the increase of industrial and

commercial investment among the middle classes, and also on the growth of collective holding of shares and debentures by bodies which include a large number of working-class members. Why trouble to destroy capitalism if capitalism is in process of becoming a system leading not to the concentration of property in the hands of a few, but to its diffusion over an ever-increasing section of the entire population?

As we have already seen, this diffusion of ownership is to a great extent a fact; but it carries with it practically no control by the owners of industry over the use which is made of their property. Nor does it effectively extend even now beyond the middle classes, though a large section of the working class may be said to have acquired an analogous interest in investment through the spread of the Co-operative movement. There is, however, a vital difference between Co-operative and joint stock investment, in that the Co-operative investor does not stand under any conditions to make a capital profit. His shares in the Co-operative Society can never rise above par because the purchase of new shares at par remains always open. The Co-operative Society pays interest on its capital, but it is not a profit-making body, and there is accordingly no possibility of a capital increment accruing to the Co-operative investor. This principle of open membership is indeed vital to the Co-operative organisation, and it is the absence of this principle that differentiates the true Co-operative

Society from such quasi-co-operatives as the Army and Navy Stores.

The main point is, however, that the diffusion of the ownership of industrial capital over the middle as well as the upper class has by no means altered the essential characteristic of capitalism as a system based upon the exploitation of labour, or prevented it from involving as it develops a closer and closer control over large masses of capital by a small body of very rich capitalists. The fact that a large section of the population has nowadays a direct financial stake in the prosperity of capitalist industry serves doubtless as a powerful bulwark of capitalism against the attacks launched upon it by Socialism and the working-class movement. It gives capitalism in this country, and to an even greater extent in the United States, a large mass of support from these intermediate groups. But not even in the United States has the practice of industrial shareholding spread far down the working class, and in this country the direct ownership of capitalist industry by working-class people is still on an infinitesimally small scale. For even the collective investment of working-class savings takes place far more in gilt-edged securities than in ordinary industrial holdings, and the working man who has money saved by means of an insurance company or a building society does not become conscious of any links binding him to the interest of large-scale capitalism.

Moreover it is easy to exaggerate, as Mr. Runciman,

for example, has frequently done, the number of small shareholders in capitalist industry. The practice of spreading investments, which has become the general rule in modern times, results in the same person turning up over and over again as a small shareholder in a large number of separate concerns. If each separate shareholding is regarded as representing a separate individual, naturally the number of shareholders appears to be enormous; but actually it is relatively small, though some types of industry, notably the railways, do include a very large number of individual small owners among the holders of their stocks. It is easy to exaggerate the degree to which the ownership of property has in modern times become diffused, and a mere glance at the statistics of fortunes passing at death serves to correct the impression that a high proportion of the population in fact possesses capital assets to any considerable amount. Diffusion of ownership has been proceeding to a considerable extent, but it has made no measurable approach to bringing about any real democratisation even of the ownership of capital, to say nothing of its effective control.

Nor should it be forgotten that some part of the apparent diffusion that has taken place has been due rather to a change in the forms of property than to a real decrease in economic inequality. The small owner tends to-day to hold a larger proportion of his capital assets in shares and debentures, and a smaller

proportion in the form of direct property, such as land and houses and the fixed and working capital of small productive enterprises. This shifting in the character of small ownership gives an illusory appearance of democratisation to capitalist industry.

Nevertheless small ownership does present to the Socialist a formidable problem, in that it makes likely a strongly organised resistance, taking shape perhaps in some form of Fascism, on the part of a large section of the middle class to any confiscatory form of Socialism, and therefore compels those who are aiming at a peaceful transition from Capitalism to Socialism to take precautions for tempering the wind to the small owner. This becomes a very vital point in considering plans for the socialisation of industry, especially in connection with the forms and amounts of compensation to be paid. For while Socialists clearly cannot in accordance with their principles recognise permanent claims based on the ownership of the means of production, and their legislation is therefore bound to be confiscatory in the last resort, equally they cannot afford, if they are aiming at a transition to Socialism by constitutional means, to stir up the whole body of small property-owners against them at the outset by an immediate threat of confiscation.

To discuss in detail the solution of this problem would take me far beyond the scope of this chapter. Broadly, the conclusions to which it points seem to be these. First that, in any plan of compensation that may

be adopted in connection with the socialisation of industries, it will be necessary to ensure to the small property-owner a continuance of income for a substantial period of years after the actual ownership of the capital assets has passed into the hands of the State. This could clearly be done by some form of terminable or life annuity. Secondly, that a system of alienation of property claims by the State can be operated with far less injustice and friction by a drastic increase in the taxation of inheritance than by confiscatory measures applied industry by industry as each particular branch of production is taken over. For in this old and settled country, with its long capitalist tradition behind it, inheritance is an enormously important factor not only in perpetuating but also in increasing inequalities of wealth; and inheritance taxation is far more effective, if properly graduated, than any other way of alienating private property to the public in redressing inequalities and making confiscation fall most heavily upon the great capitalists. The working out of these principles into a practical policy of compensation is one of the most important tasks at present confronting the Socialist movement.

If socialisation follows broadly the lines just suggested there will presumably be, while the transition from Capitalism to Socialism is in progress, some continuance of private investment; and it will be necessary for the State, as it becomes increasingly the

owner and controller of industry, not only to direct the private investment of capital into the most socially desirable channels, but also itself to take steps, by means of a National Investment Board, to mobilise private savings and apply them directly to the development of necessary productive services. How this can best be done is discussed in another section in this volume, and I do not propose to pursue the matter here. It is, however, clear that the way has been prepared for a system of investment through State agencies both by the enormous growth of the National Debt, which has accustomed small as well as large shareholders to the holding of public securities, and by the almost complete divorce which already exists between the ownership of industrial property and the control of its actual use. The shareholder has got accustomed to handing over his money to a body which will take complete control of its employment, and to forgoing all effective part in the direction of the policy of the businesses of which he becomes part owner. This makes it easier for the State to take over private capital on terms which will remove from the shareholders the purely nominal control which is all that is left to them to-day, and make them in theory, what they are now in fact, pure *rentiers*, claiming on the strength of their investments a share in the product of industries which they do nothing to influence or direct.

There arises at this point a highly interesting

question which urgently demands thought on the part of those who are setting out to socialise both industries and the processes of investment. Until recently it has always been taken for granted that when any industry was socialised its previous owners would get by way of compensation for their holdings, whether these were bonds or equities, a form of fixed-interest-bearing security which would guarantee them an income regardless of the actual profitability of the enterprise after socialisation. Socialists thought of themselves as having a mission to attack primarily profits, and only thereafter and by a subsequent process the receipt of interest. The profit-maker was thought of as the real exploiter, and the interest-receiver as a far more harmless person who could be left to be dealt with subsequently by taxation, including the taxation of inheritance. But the events of the past few years, and especially the catastrophic fall in prices which has taken place, have made most of us far more alive than we were before to the dangers of the fixed-interest system ; and it is not too much to say that to-day the receiver of interest, far more than the receiver of profit, is the chief burden weighing upon the productive classes. For in times of falling prices the real incomes of the recipients of fixed interest are sharply raised at the expense of wage-earners and profit-makers alike ; and if prices fall far enough the burden of debts becomes intolerable, as it has done over a large part of the world to-day. It is, moreover,

increasingly realised to be dangerous to subject any form of enterprise to a large fixed-money charge which it has to meet irrespective of possible fluctuations in its receipts owing to price changes or to other causes. And it can be argued that it is no less unsound for a socialised economy than for a private business to lay upon itself a burden of fixed-interest-bearing debt liable to eat up its total surplus of receipts over other costs. This question has already come up in connection with the provisions of the London Passenger Transport Act, where the workers are beginning to understand that the necessity of earning a fixed minimum dividend on the capital taken over from the private shareholders may interpose formidable difficulties in the way of trade union claims for higher wages or better conditions of work.

There is accordingly much to be said for the view that when privately owned industry is socialised compensation to its past owners should be given in the form of equity claims rather than fixed-interest-bearing bonds. In fact the preference share, rather than the debenture, seems to afford the model that can most suitably be followed in socialisation claims, though it may be necessary in practice to adopt different methods in dealing with different cases, just as joint stock companies now issue bonds and equities of varying types. If the model of the preference share were followed, the dispossessed owners of a socialised industry would receive in exchange for their holdings

not fixed-interest-bearing bonds but claims to receive dividends up to a permitted maximum out of the surplus revenues of the undertaking after costs had been met, but they would have no claim either upon the undertaking or upon the State to receive the maximum dividend unless the actual revenues showed a sufficient surplus to make the payment economically possible. It would be quite practicable to modify the effect of this system by ensuring to the ex-shareholders of the undertaking at least a minimum dividend at a relatively low level, say by allowing the rate to rise to a maximum of 6 per cent, but not allowing it to fall in any case below 3 per cent. Obviously these figures are meant only by way of illustration; for the exact terms of compensation would have to be adjusted separately in each case. My point is that the growing prevalence of preference shares, which are widely held especially among small owners of capital, has prepared the way for some form of compensation such as this—which is, indeed, foreshadowed in one of the provisions of the London Passenger Transport Act, though there the minimum level for dividend has been fixed far too high, and the amount of the contemplated fluctuation is accordingly far too small.

This whole question obviously requires far more thinking out than I can hope to give it in this section.[1]

[1] I have discussed it somewhat further in my pamphlet *The Essentials of Socialisation* (N.F.R.B.), which is also published in my volume *Economic Tracts for the Times* (Macmillan). There is also an important discussion of the problem of confiscation in Mr. G. R. Mitchison's pamphlet *Industrial Compensation* (N.F.R.B.). Much work, however, still remains to be done in this field.

My main point here and now is to emphasise the extent to which the changing forms of joint stock enterprise have actually prepared the way for the successful introduction of a system of socialisation. They have done this in several different manners. In the first place, by destroying the control exercised by the general body of shareholders over the use of their money they have obviously made far easier the introduction of a system in which on the one hand control can be socialised by the taking over of the large-scale undertakings, and on the other the property claims of the shareholders can be converted into limited claims to income in accordance with the principle of compensation outlined above. In the second place, the great elasticity characteristic of the joint stock system in its modern form with its tremendous development of subsidiary companies, interlocking directorates, exchange of shareholdings, and the like, has evidently created conditions of which the State can take advantage in planning the socialisation of industry. Many of these large interlocking capitalist undertakings have already lost all personal character, and some of them have developed into extensive concerns which could virtually be acquired by the State and carried on under public ownership without much change of form or structure, minor units being simply merged with them in order to complete the framework of the socialised industry.

This raises another issue. Hitherto Socialists have

been apt to think of the question of socialisation industry by industry. They have contemplated a succession of measures, each directed to the complete taking over of a particular industry or service, and have thought of Socialism as coming into being gradually by this method. Doubtless this is what will actually be done in the case of a number of the major industries; but it is doubtful whether this method of socialisation will be necessarily the only one, or whether it will be desirable to apply it to most of the secondary industries which are likely to be left at the outset under private operation. For there is clearly in these cases an alternative method open. If the State embarks upon a drastic policy of taxing inheritance it will be impossible for payment of the taxes so levied to be made in money, for the casting of huge blocks of shares on the market at the death of their owners would obviously greatly depreciate their value, and in many cases make the actual payment of the duty impossible. The State, therefore, if it sets out drastically to tax inheritance with the object of wiping out all major inequalities of wealth, will be compelled to accept payment in actual bonds and shares and other forms of property as well as in cash. By this method it will rapidly become part owner of the vast majority of industrial enterprises, even in those industries which are not socialised as separate units. I know that some Socialists feel a strong reluctance to accept this method of transferring capital from private to public ownership, on the

ground that it involves a transitional stage during which the State will be partly responsible for the conduct of capitalist industry. But whether this method is adopted or not this responsibility is in fact unavoidable in the course of any gradual transition to Socialism ; for even if the State does not become part owner of non-socialised industries it will nevertheless be accepting the responsibility for general industrial planning and will have, in order to maintain the volume of employment and production, to establish conditions which will render it possible for the non-socialised industries to be carried on. This it will be in a far better position to do if it is able not merely to lay down, through a national planning authority, conditions for the conduct of non-socialised enterprises, but also to assume actual shareholding power in these industries so as to appoint to them directors of its own, who will be responsible for watching the public interest and seeing that the terms of the national plan are duly complied with. Of course State directors serving on the boards of partially socialised enterprises will under these conditions by no means accept the restrictions which the State has imposed on itself in connection with its appointed directors on the Anglo-Persian Oil Company, in which we have already an instance of the State becoming a large shareholder in a capitalist concern. Under conditions of rapid transition to a Socialist economy, of which I am now thinking, the State directors will take as

representatives of the public interest an active and constantly increasing part in the conduct of the business, and in the direction of its policy in accordance with the requirements of the National Industrial Plan.

This question, too, cannot be pursued further in this section, though it opens up large possibilities for more detailed discussion. I can only in this place throw out the suggestion that socialisation needs to be considered from this point of view, as well as from the standpoint of bringing particular industries of key importance under direct public ownership and control. It is relevant to this section only to the extent to which the development of the joint stock system, which I have been endeavouring to outline, definitely points the way towards this form of socialisation, as well as towards the more familiar method of direct transference of an entire industry from private to public hands.

RECENT CAPITAL ISSUES

by

A GROUP OF CAMBRIDGE ECONOMISTS

WITH A FOOTNOTE BY ERNEST DAVIES

RECENT CAPITAL ISSUES

THE TABLES and figures that follow are drawn from an analysis of prospectuses advertised in the *Financial Times* during the past seven years. A slightly greater number than appear in the *Financial Times* is given in the *Economist*, but only in a summarised form, and not always containing all the particulars which we have endeavoured to obtain. The figures refer to issues made to the general public only, and they do not include private issues made by the companies to their own shareholders. It has to be borne in mind, too, that quite often the prospectuses were published in an abridged form, or in the form of an "Offer for Sale," from neither of which could full particulars be obtained, and this fact has decreased the value of the material in this analysis.

Table I*a* shows the total amount of money raised by new issues in the London capital market for each of the seven years 1927 to 1933 : it includes issues both for use at home and for use overseas. The total is that of all prospectuses advertised in the *Financial Times* added together for each year, and it includes the Treasury Conversion Loans of £105 million in 1930 and £141 million in 1933, besides some other smaller conversion loans ; in the 1932 figures conversion issues

made by the Government, which were designed for those people who already held Government Stock, are excluded.

Table I*b* has been drawn up so that our figures could be compared with the annual figures published by the *Midland Bank Review* and (since 1930) by the Bank of England. The British Treasury Conversion Loans have been excluded, as has also any other issue which was stated in the prospectus to be solely for conversion purposes. In drawing up this table, some difficulty has been experienced in determining from the statements in the prospectuses the exact direction in which the money was to be used. Furthermore, in some cases, although the bulk of the money has been raised for conversion purposes, the rest has been wanted for some other use. Only those prospectuses have been excluded from this table in which it was reasonably clear that the money raised would be used solely for conversion purposes. It will be seen that our figures are always less than those published by the Midland Bank and the Bank of England, the reason being, of course, that not every issuer publishes an advertisement in the *Financial Times*. The nearest approach of our figures to those of the Midland Bank is in 1930, 1931, and 1932, the years of depression, when, as will be seen from Table VII, a very large proportion of the new capital raised was used for conversion and the repayment of bank loans.

TABLE I*a*

Total New Issues (given by Prospectuses) 1927–1933

(£'s, 000's omitted)

1927	1928	1929	1930	1931	1932	1933
242,595	222,649	113,799	345,827	68,234	382,809	410,348

TABLE I*b*

New Issues, 1927–1933 (excluding British Government Issues and all Issues *solely* for Conversion Purposes)

Issues in *Financial Times* compared with Annual Figures given in the *Midland Bank Review*

(£'s, 000's omitted)

(Bank of England estimates for 1930 and after)

	1927	1928	1929	1930	1931	1932	1933
Prospectuses	239,796	221,407	113,799	220,627	63,477	80,496	105,091
Midland Bank	315,000	363,000	254,000	234,700	89,600	115,000	129,600

TABLE

Total Overseas Issues and Home Issues given

(£'s, 000's

	1927		%	1928		%	1929		%
Overseas	139,426	..	57·5	100,222	..	45·0	41,613	..	36·6
Home	103,169	..	42·5	122,427	..	55·0	72,186	..	03·4
Total	242,595	..	100·0	222,649	..	100·0	113,799	..	100·0

TABLE

Overseas and Home Issues compared,
Issues and all Issues solely

Issues in *Financial Times* Prospectuses compared with
the Bank

(£'s, 000's

		1927	1928
OVERSEAS	Prospectuses	128,000	100,000
	Midland Bank	139,000	144,000
HOME	Prospectuses	130,000	122,000
	Midland Bank	176,000	219,000

IIa

by Prospectuses compared, 1927–1933

omitted)

1930	%	1931	%	1932	%	1933	%
119,061..	34·4	38,922..	57·0	30,242..	8·0	162,526..	39·6
226,766..	65·6	29,312..	43·0	352,567..	92·0	247,822..	60·4
345,827..	100·0	68,234..	100·0	382,809..	100·0	410,348..	100·0

IIb

1927–1933, excluding British Government for Conversion Purposes

the Annual figures in the *Midland Bank Review* and of England

omitted)

1929	1930	1931	1932	1933
42,000	107,000	39,000	27,000	47,000
95,000	114,000	50,000	29,000	39,000
72,000	113,000	25,000	50,000	58,000
159,000	121,000	40,000	86,000	91,000

Table II*a* shows in absolute and percentage figures the total borrowing for overseas concerns compared with that for home concerns during the seven years. If the large-scale conversion loan of £105 million issued by the British Treasury in 1930 and similar loans of £292½ million in 1932 are deducted from the figures of home issues, the total for home and overseas investments can be seen to be much closer than would otherwise appear.

Table II*b* is constructed on the same plan as Table I*b*; that is to say, all issues which are definitely stated to be wanted solely for conversion purposes have been excluded. Our figures are then compared with those of the Midland Bank and the Bank of England constructed on the same lines. Again it will be seen that our figures are lower each year than the others—for the same reason as before—and they approach closely together in 1930–33, when a large proportion of the issues were being made for conversion.

Table III gives an analysis of the types of issues made by overseas concerns. The chief interest in the table lies in the fact that, as one might expect, in the two relatively good years of 1928 and 1929 the percentage of money invested in foreign industrial concerns rose considerably, but that in the years of depression of 1930 to 1932 the vast bulk of foreign investment was made in Government or municipal loans. In 1933 nearly £4 million was floated for mining companies (gold and tin); of the large total

of Government and municipal borrowing, £119 million was for conversions.

Table IV*a* shows the totals for different types of issues made by home concerns. Table IV*a* should be supplemented by Table IV*b*, which gives a more detailed analysis of the component classes of investment in the three groups of Table IV*a*, which have been gathered under the headings "Production," "Distribution," and "Investment Trusts." Municipalities refrained from issuing loans (as might be expected) during the period of industrial activity in 1928 and 1929, and they re-emerged upon the scenes in 1930 and 1931. In 1932 municipal issues were discouraged by the Treasury in order to facilitate Government conversion operations. In 1933 a certain amount of municipal conversion took place.

The class of issues grouped under the heading "Production" includes, as will be seen from Table IV*b*, gas, water, and electricity, food, drink, and tobacco, mining and quarrying, as well as all manufacturing undertakings. It may seem surprising at first sight that it retained so high a proportion of new issues in the home market, even after the industrial depression had set in. The figures of 24 per cent and 26 per cent for the years 1930 and 1931 appear to be very creditable. They were, however, very narrowly dispersed. Table IV*b* shows this well : four only of the nineteen sub-classes accounted for over £40 million of the £54 million invested in production in 1930.

TABLE

Analysis of Overseas Issues from

(£'s, 000's

	1927	%	1928	%	1929	%
Government and Municipal	102,274..	73·3	68,836..	68·7	28,593..	68·7
Railway	14,539..	10·4	—	—	3,835..	9·2
Others	22,613..	16·3	31,386..	31·3	9,185..	22·1
Total	139,426..	100·0	100,222..	100·0	41,613..	100·0

TABLE

Analysis of Home Issues from

(£'s, 000's

	1927	%	1928	%	1929	%
Government	—	—	—	—	—	—
Municipal	26,019..	25·2	13,881..	11·3	1,210..	1·7
Production	38,603..	37·4	48,699..	39·8	42,015..	58·2
Patents and Fads	1,095..	1·1	6,615..	5·4	3,417..	4·7
Distribution	25,341..	24·6	29,779..	24·3	7,477..	10·3
Investment Real Estate	12,111..	11·7	23,453..	19·2	18,067..	25·0
Total	103,169..	100·0	122,427..	100·0	72,186..	99·9

III

published Prospectuses, 1927–1933

omitted)

1930	%	1931	%	1932	%	1933	%
101,714..	85·4	32,072..	82·4	30,242..	100·0	153,151..	94·2
9,622..	8·1	2,850..	7·3	—	—	—	—
7,725..	6·5	4,000..	10·3	—	—	9,375..	5·8
119,061..	100·0	38,922..	100·0	30,242..	100·0	162.526..	100·0

IV*a*

Published Prospectuses, 1927–1933

omitted)

1930	%	1931	%	1932	%	1933	%
105,000*	46·3	—	—	292,500*	82·9	141,000..	56·9
29,781..	13·1	7,177..	24·5	6,678..	1·9	19,134..	7·7
54,401..	24·0	7,588..	25·9	37,679..	10·6	64,820..	26·2
237..	0·1	—	—	50..	—	538..	0·2
28,385..	12·5	11,433..	39·0	12,330..	3·4	7,965..	3·2
8,962..	4·0	3,114..	10·7	3,330..	1·0	14,365..	5·8
226,766..	100·0	29,312..	100·1	352,567..	99·8	247,822..	100·0

* These loans were made solely for conversion purposes.

TABLE

Further Analysis of Three Groups

(£'s, 000's

PRODUCTION	1927	1928	1929	1930	1931	1932	1933
Gas, Water, and Electricity*	10,165	6,161	9,787	25,043	7,392	25,821	14,465
Food, Drink, and Tobacco	10,093	5,031	13,167	3,263	—	900	14,822
Mining and Quarrying	2,108	—	550	130	—	—	—
Coal, Coke, etc.	—	—	1,562	—	—	441	—
Textiles	4,840	9,943	1,328	100	—	—	453
Clothing and Boots	830	3,141	2,100	399	—	500	2,838
Furniture	—	583	—	—	—	—	—
Building	—	131	485	—	—	—	—
Glass, Pottery, Bricks, etc.	2,818	876	630	—	—	—	1,983
Unbreakable Glass	—	932	—	—	—	—	—
Chemicals, Paint, and Oil	400	682	—	—	—	385	—
Engineering	659	1,645	584	—	—	—	—
Metal	425	1,978	4,186	—	—	852	4,453
Motors, Aircraft, and Garages	747	4,223	224	—	—	—	2,296
Wireless and Electrical	—	115	1,008	3,680	—	368	940
Gramophones	157	3,947	1,235	—	—	—	250
Paper	1,112	785	624	9,800	—	1,000	5,382
Newspapers and Printing	940	5,070	1,658	1,716	196	3,443	11,119
Other Manufactures	3,310	3,456	2,887	10,270	—	3,969	5,818

* Gas, Water, and Electricity, excluding municipal enterprise; including an issue of £7,480,000 by the Central Electricity Board in 1933.

of New Issues in Table IV*a*

omitted)

	1927	1928	1929	1930	1931	1932	1933
DISTRIBUTION							
Road Hauliers	287	985	—	60	—	100	—
Railways	—	3,840	—	16,119	—	8,162	—
Shipping	9,990	2,175	—	2,665	950	2,021	185
Wholesale and Retail Dist.	11,965	11,992	3,707	8,630	10,401	660	4,241
Hotels and Restaurants	310	748	—	—	—	—	1,768
Entertainment	2,474	8,761	2,955	582	82	1,387	1,390
Non-Manufacturing Services	315	1,278	815	329	—	—	381
INVESTMENT TRUSTS, ETC.							
Real Estate	1,398	2,963	1,950	1,613	1,980	1,180	11,048
Investment Trusts	10,713	20,490	11,117	3,596	1,134	250	2,500
Banking and Insurance	—	—	5,000	3,753	—	1,900	817

£25 million of this £40 million was invested in gas, water, and electricity undertakings alone, over £3 million in food, drink, and tobacco, nearly £4 million in wireless and electrical manufactures, and nearly £10 million in paper manufacturing (an issue made by *one single* undertaking). In 1931 the dispersion was even narrower. Table IV*b* shows that £7·4 million out of the total of £7·6 million invested in the group " Production " was invested in gas, water, and electricity alone. The same kind of dispersion took place in 1932, as can be seen from Table IV*b*. In that year gas, water, and electricity issues accounted for about two-thirds of the total of this class. In 1933 the total was larger and the dispersion broader, but there remain some curious features. There was a revival of issues for constructional purposes—iron and steel building materials—but very little in textiles. The total shown for 1933 under this heading included an issue of £100,000 by a linen company and a much larger figure by another company for the purpose of scrapping surplus machinery !

The " Food and Drink " heading shows a large rise in 1933, which is mainly due to brewery issues.

In 1928 and 1929 there was nothing comparable to this excessive overweighting of a few sub-classes of issue. The investments were far more evenly distributed over the whole group. The largest single item was that of £13 million (out of a total of £42 million for the whole group) which was invested in food, drink, and tobacco

in 1929: the net largest single item during these two years was nearly £10 million (out of a total of £49 million for the whole group) invested in textiles in 1928, the year of the boom in artificial silk.

The next group has been named "Patents and Fads." We did our best to satisfy ourselves—and recent history has made the task considerably easier—that the undertakings included in this group were of a highly speculative character. It is interesting to see that this type of issue makes, as might have been expected *a priori*, a sudden appearance during the years of good trade, collars 5 per cent of the total money invested at home, and disappears again to insignificant proportions as soon as a depression has set in: £6·6 million were spent in this way in 1928. It was only $5\frac{1}{2}$ per cent of the total money invested at home in 1928, but it would have been nearly 25 per cent of the total money invested at home in 1931. Two considerable patent medicine issues in 1933 may therefore be taken as a sign of reviving trade.

The next group of issues is "Distribution," and it includes, besides whole and retail distribution, shipping, railways, and road transport, hotels and restaurants, entertainments, and non-manufacturing services, which includes laundries. New issues for railways of £16 million were made in 1930, these issues being made chiefly by the underground railways of London—for extensions—but a not inconsiderable issue, amounting to nearly £3 million each, being

made by the Southern and the London and North-Eastern Railways, presumably in connection with electrification. The same is true for 1932, when issues for over £8 million were made by the Southern and Metropolitan Railways. Nearly £10 million was invested in shipping in 1927, the White Star Line accounting for over £5 million of this. Entertainment had a great outburst of activity in 1928, when London decided that it had not enough theatres and cinemas. The issues in this class sank back again to insignificant proportions in 1930 and 1931, only to revive in 1932. The group of issues gathered under the heading "Wholesale and Retail Distribution," although being unaccountably set back in 1929 to below £4 million compared with its £12 million in the two preceding years, yet showed development in 1930 and 1931, though they were quite insignificant in 1932. In 1930 they rise to nearly £9 million (thus forming the bulk of the new issues in this group except for the railway issues), and in 1931 to £10·4 million, accounting for over 90 per cent of the new issues in the group for that year. The new issues in the class "Wholesale and Retail Distribution" were made, however, by only four companies in 1930 and by only four in 1931. One of the four in 1931 was an issue by F. W. Woolworth & Co. for over £9 million, i.e. about 90 per cent of the total issues in this sub-class for that year. In 1930, too, there was a single issue of over £6 million by the Shell Transport and Trading Company, and

another of £2 million by Marks & Spencer. It cannot be definitely stated from the figures, and from our analysis, that "Wholesale and Retail Distribution" is an expanding industry, because of the difficulties of determining from the prospectuses how the new money will be spent, and the figures for 1932 at any rate show that even if there is expansion, it is probably not continuous. Nevertheless, it can be borne in mind in this connection that neither Marks & Spencer nor F. W. Woolworth & Co. use new money for the purpose of buying up existing businesses: the money they raise is more likely to be used for new capital. In 1933 the total for the group was lower than in 1932, and almost the whole of the money raised was for retail distribution. The only other big issue was by Messrs. Lyons under the "Hotel and Restaurant" heading. Among the "Non-manufacturing Services" we have included an issue for the Stock Exchange Co. itself.

An interesting comparison might be made between the total new issues for each of the seven years and the increase or decrease in employment in these various groups. Such a comparison might be expected to give some additional indication as to whether the new money raised was being used to provide new capital or not.

Finally there is the class containing issues made by investment trusts and real estate companies. Banking has also been included here (including the Agricultural Mortgage Corporation), and it accounted for £5 million and £4 million in 1929 and 1930 respectively.

In 1932 there was an issue of nearly £2 million by the Agricultural Mortgage Corporation. The history of issues by investment trusts is what one might expect: they rise to a maximum in 1928 and then fall off rapidly in 1930, 1931, and 1932. But the most interesting feature is the remarkable rise in real estate flotations in 1933.

Table V lives up to *a priori* expectations. It concerns the amounts raised by issuing ordinary or preference shares or by issuing debentures during the seven years. All issues, both for home and overseas, are included. For the purposes of the table, Government and municipal loans have been placed under the heading "Debentures." In the years of good trade more money is invested in ordinary and preference shares, and in years of depression a much greater proportion is invested in debentures.

TABLE

Methods of raising New Capital.

(£'s, 000's

	1927	%	1928	%	1929	%
Ordinary	28,773 ..	11·9	50,827 ..	22·8	33,613 ..	29·5
Preference	32,406 ..	13·3	42,852 ..	19·2	16,913 ..	14·0
Debentures	181,416 ..	74·8	128,970 ..	57·9	63,273 ..	56·5
Total	242,595 ..	100·0	222,649 ..	99·9	113,799 ..	100·0

* Including British Treasury Conversion Loans. The percentage for 1930 *excluding* this

	1930
Ordinary	4·6
Preference	6·1
Debentures	89·3

Tables VI and VII deal with methods of spending capital. They have been put together in the following manner: If in a prospectus it was definitely stated that a certain amount of money would be used for a particular purpose, the amount so allocated would be put down to one of the four definite classes. If the money was to be used for taking over some business already in existence, then it was put down under the heading "Existing Assets Acquired." If it was definitely to be allotted to building new plant or for the erection of new machinery, or definitely to be used for working capital, it was placed under the heading "New Capital," which therefore includes both fixed and working new capital. If it was to be used for the repayment of bank loans or for some similar purpose, it was placed under the heading

V

All issues, 1927–1933

omitted)

1930	%	1931	%	1932	%	1933	%
11,140 ..	3·2	5,016 ..	7·4	1,369 ..	0·4	11,362 ..	2·8
14,675 ..	4·2	5,802 ..	8·5	11,205 ..	2·9	18,324 ..	4·5
320,012* ..	92·5	57,416 ..	84·1	370,235* ..	96·7	380,662* ..	92·7
345,827 ..	99·9	68,234 ..	100·0	382,809 ..	100·0	410,348 ..	100·0

conversion loan and excluding conversion loans in 1932 and 1933 would be as follows:

1932	1933
1·6	4·2
12·4	6·8
86·0	89·0

"Conversion." If the amount of preliminary expenses were given—the amount spent on underwriting commission, law costs in relation to issuing the prospectus, accountants' and valuers' fees, costs of advertising the issue, etc.—these were placed under the appropriate heading. It is important to remark, however, that although the law in relation to the issue of prospectuses definitely states that the amount spent on preliminary expenses must be mentioned, yet it is sometimes exceedingly difficult, and at other times (when only an abridged prospectus is published) impossible to trace the amount spent in this way. All the rest of the money raised, if not definitely allotted to some specific purpose in the prospectus, was placed under the heading "Ambiguous." It was assumed that all issues were fully allotted—an assumption which might not have been correct in some cases—and the amount placed under the heading "Ambiguous" was in every case the residue of the total new issue less any amounts definitely appropriated to specific purposes. The amount in the ambiguous class therefore might have been over-estimated, because all the issues might not have been fully allotted; but, even allowing for this, it was impossible to tell from most of the prospectuses what was going to be done with the bulk of the new capital raised. It will be seen from the first columns of percentages figures in Table VI that, leaving the year 1932 out of account, if all issues, both from home and from overseas, are considered, the percentage in

the "Ambiguous" class ranges from 63 to 76. The second column of percentages shows the proportion of new capital that can be definitely allotted to specific purposes during the seven years. The years 1932 and 1933 show a welcome fall in the percentage of the ambiguous class. This was largely due to the large number of issues for purposes of conversion, but, leaving these out of account, the percentage definitely allocated to new capital purposes compares very favourably indeed with those of the preceding years. Omitting conversion, the percentage of "Ambiguous," which averaged nearly 80 per cent in 1927–30, stood at approximately 35 per cent in 1932 and 1933.

In Table VII the methods of spending capital have been subjected to a further analysis. All overseas issues have been excluded on the ground that the class "Existing Assets Acquired" in regard to the overseas issues probably means "New Capital" from the point of view of the British investor. The Government conversion loan of £105 million in 1930 has also been excluded. The figures that remain show that, except in 1932, the class "Ambiguous" ranges from 60 to 88 per cent, and Table VIII shows that the great bulk of this ambiguous expenditure in 1930 came from the group "Production." If the ambiguous expenditure is excluded and the proportions of money that can be definitely allotted to specific purposes alone considered, as is done in the second column of percentages for each year, the following points emerge:

TABLE VI

Methods of spending New Capital. All Issues, 1927–1933

		Existing Assets Acquired	New Capital	Conversion and Re-payment of Loans	Prelimin-ary Expenses	Ambiguous	Total
	£	24,187	17,589	12,200	2,985	185,634	242,595
1927	%	10·0	7·3	5·0	1·2	76·5	100·0
	*%	42·6	30·8	21·4	5·2	—	—
	£	31,940	23,026	19,295	4,876	143,512	222,649
1928	%	14·3	10·3	8·7	2·2	64·4	99·9
	*%	40·4	29·1	24·4	6·2	—	—
	£	10,038	9,700	9,649	2,501	81,911	113,799
1929	%	8·8	8·5	8·5	2·2	72·0	100·0
	*%	31·5	30·4	30·2	7·8	—	—
	£	1,794	1,593	123,685	1,243	217,512	345,827
1930	%	0·5	0·5	35·8	0·4	62·9	100·1
	*%	1·3	1·2	96·4	1·1	—	—
	£	588	15,238	8,418	167	43,823	68,234
1931	%	0·9	22·3	12·3	0·2	64·2	99·9
	*%	2·4	62·4	34·5	0·7	—	—
	£	4,837	33,800	322,927	956	20,219	382,739
1932	%	1·3	8·8	84·3	0·3	5·3	100·0
	*%	1·3	9·3	89·1	0·3	—	—
	£	24,142	35,384	314,944	2,523	33,359	410,352
1933	%	5·9	8·6	76·8	0·6	8·1	100·0
	*%	6·4	9·4	83·5	0·7	—	—

* The second column of percentages shows the proportion of money spent in various ways each year, when the class "Ambiguous" is excluded from consideration.

TABLE VII

Methods of spending New Capital—Home Government Issues and all Overseas Issues excluded. 1927–1933

(£'s, 000's omitted)

		Existing Assets Acquired	New Capital	Conversion and Re-payment of Loans	Prelimi-nary Expenses	Ambiguous	Total
	£	19,673	3,966	6,026	2,232	71,272	103,169
1927	%	19·1	3·8	5·8	2·2	69·1	100·0
	%	61·7	12·4	18·8	7·0	—	—
	£	27,145	11,818	5,502	4,195	73,767	122,427
1928	%	22·2	9·6	4·5	3·4	60·3	100·0
	%	55·8	24·3	11·3	8·6	—	—
	£	9,051	6,197	2,639	2,194	52,105	72,186
1929	%	12·5	8·6	3·6	3·0	72·2	99·9
	%	45·1	30·9	13·1	10·9	—	—
	£	1,794	1,021	10,202	911	107,838	121,766
1930	%	1·5	0·8	8·4	0·7	88·5	99·9
	%	12·9	7·3	73·2	6·5	—	—
	£	588	92	7,468	147	21,017	29,312
1931	%	2·0	0·3	25·5	0·5	71·7	100·0
	%	7·1	1·1	90·0	1·8	—	—
	£	4,837	29,992	17,203	956	7,079	60,067
1932	%	8·5	49·9	28·6	1·7	11·2	99·9
	%	9·1	56·6	32·4	1·9	—	—
	£	18,757	22,469	52,085	2,181	11,334	106,826
1933	%	17·5	21·0	48·7	2·0	10·6	99·8
	%	19·6	23·6	54·6	2·2	—	—

TABLE

Details concerning Money Raised and

(£'s, 000's

	Ordinary	Preference	Debentures	Total
1927				
Overseas Government and Municipal	—	—	102,274	102,274
Overseas Railways	5,250	—	9,289	14,539
Other Overseas	2,923	5,482	14,208	22,613
Home Government	—	—	—	—
Home Municipalities	—	—	26,019	26,019
Home Production	8,367	10,599	19,637	38,603
Home Patents and Fads	770	325	—	1,095
Home Distribution	4,518	14,072	6,751	25,341
Home Investment Trusts, etc.	6,945	1,928	3,238	12,111
1928				
Overseas Government and Municipal	—	—	68,836	68,836
Overseas Railways	—	—	—	—
Other Overseas	8,826	2,100	20,460	31,386
Home Government	—	—	—	—
Home Municipalities	—	—	13,881	13,881
Home Production	19,914	18,500	10,285	48,699
Home Patents and Fads	3,185	3,090	340	6,615
Home Distribution	7,485	11,724	10,570	29,779
Home Investment Trusts, etc.	11,417	7,438	4,598	23,453
1929				
Overseas Government and Municipal	—	—	28,593	28,593
Overseas Railways	—	1,000	2,835	3,835
Other Overseas	3,455	625	5,105	9,185
Home Government	—	—	—	—
Home Municipalities	490	—	720	1,210
Home Production	14,179	12,863	14,973	42,015
Home Patents and Fads	2,467	950	—	3,417
Home Distribution	1,657	1,475	4,345	7,477
Home Investment Trusts, etc.	11,365	—	6,702	18,067
1930				
Overseas Government and Municipal	—	—	101,714	101,714
Overseas Railways	—	—	9,622	9,622
Other Overseas	250	—	7,475	7,725
Home Government	—	—	105,000	105,000

Spent by Various Classes of Issue

omitted)

Existing Assets Acquired	New Capital	Conversion and Repayment of Loans	Preliminary Expenses	Ambiguous
1,000	10,701	3,300	—	87,273
1,000	2,136	2,084	394	8,925
2,514	786	790	359	18,164
—	—	—	—	—
—	—	757	—	25,262
11,720	2,941	2,097	1,027	20,818
198	267	—	104	526
6,848	758	2,998	873	13,864
906	—	174	229	10,802
—	9,005	8,647	—	51,184
—	—	—	—	—
4,795	2,203	5,146	681	18,561
—	—	—	—	—
—	—	500	—	13,381
13,084	8,471	1,484	2,473	23,187
2,316	1,723	—	536	2,040
10,493	1,116	3,052	685	14,433
1,252	508	466	501	20,726
—	1,890	7,010	—	19,693
—	—	—	—	3,835
987	1,613	—	307	6,278
—	—	—	—	—
—	—	—	—	1,210
6,535	3,521	715	1,189	30,055
548	1,718	—	317	834
752	958	1,924	398	3,445
1,216	—	—	290	16,561
—	—	6,197	—	95,517
—	75	900	115	8,532
—	497	1,386	217	5,625
	—	105,000	—	—

1930—*continued*	Ord-inary	Pre-ference	Deben-tures	Total
Home Municipalities	—	—	29,781	29,781
Home Production	9,160	2,840	42,401	54,401
Home Patents and Fads	—	—	237	237
Home Distribution	222	11,085	17,078	28,385
Home Investment Trusts, etc.	1,508	750	6,704	8,962
1931				
Overseas Government and Municipal	—	—	32,072	32,072
Overseas Railways	—	—	2,850	2,850
Other Overseas	—	—	4,000	4,000
Home Government	—	—	—	—
Home Municipalities	—	—	7,177	7,177
Home Production	109	165	7,314	7,588
Home Patents and Fads	—	—	—	—
Home Distribution	4,907	5,235	1,291	11,433
Home Investment Trusts, etc.	—	402	2,712	3,114
1932				
Overseas Government and Municipal	—	—	30,242	30,242
Overseas Railways	—	—	—	—
Other Overseas	—	—	—	—
Home Government	—	—	292,500	292,500
Home Municipalities	—	—	6,678	6,678
Home Production	917	10,160	26,602	37,679
Home Patents and Fads	50	—	—	50
Home Distribution	152	1,045	11,133	12,330
Home Investment Trusts, etc.	250	—	3,080	3,330
1933				
Overseas Government and Municipal	—	—	153,151	153,151
Overseas Railways	—	—	—	—
Other Overseas	3,698	150	5,527	9,375
Home Government	—	—	141,000	141,000
Home Municipalities	—	—	19,135	19,135
Home Production	3,798	12,904	41,133	57,835
Home Patents and Fads	100	438	—	538
Home Distribution	1,102	1,538	4,595	7,235
Home Investment Trusts, etc.	1,591	2,265	11,239	15,095

continued

Existing Assets Acquired	New Capital	Conversion and Repayment of Loans	Preliminary Expenses	Ambiguous
—	—	6,575	—	23,206
1,660	803	3,411	645	47,882
134	—	—	5	98
—	26	208	238	27,913
—	192	8	23	8,739
—	15,146	950	—	15,976
—	—	—	—	2,850
—	—	—	20	3,980
—	—	—	—	—
—	—	3,701	—	3,476
—	—	3,767	8	3,813
—	—	—	—	—
25	92	—	84	11,232
563	—	—	55	2,496
—	3,878	13,224	—	13,140
—	—	—	—	—
—	—	—	—	—
—	—	292,500	—	—
—	1,256	4,672	—	750
3,678	21,078	7,096	240	5,587
4	13	—	3	30
862	5,745	4,410	713	600
293	1,900	1,025	—	112
2,000	11,260	118,775	—	21,116
—	—	—	—	—
3,384	1,654	3,084	342	911
—	—	141,000	—	—
—	4,156	12,053	—	2,926
12,174	13,505	25,952	1,352	4,852
238	274	—	26	—
712	1,334	4,406	306	477
4,469	2,647	6,119	476	1,384

Of the money that is definitely allotted to some specific purpose during the years 1927 to 1931, one and a half to six times as much was spent on buying up existing assets as was spent on new capital. This proportion is likely to be an under-estimate rather than an over-estimate, for it is to be supposed that *concerns will make the highest possible estimate they can of the amount which will be left over for working capital.* The amount spent on preliminary expenses, on the other hand, is almost certainly an under-estimate; for, owing to the fact that so many abridged prospectuses are issued, it is often possible only to include the underwriting commission under the heading "Preliminary Expenses," and occasionally not even this is stated. The heading "Conversion" is also probably a considerable under-estimate. Companies are rather reluctant to divulge the amount they are indebted to their bankers, and consequently they often avoid a definite statement of the amount of the bank loan which they have to repay by announcing that the purpose of the issue is the "Repayment of bank loans and general purposes of the company," or some similar statement which is not remarkable for the completeness of the information it conveys. The amounts of money concerned in statements of this kind have, of course, been placed under the "Ambiguous" heading. Again an exception must be made of the years 1932–33, but it is too early to tell how long this improvement is likely to last.

With regard to Table VII, therefore, it can be said that the amounts attributed to new capital are probably not under-estimated, and that the amounts attributed to each of the other three headings are almost certainly and in every case grossly under-estimated.

Finally, Table VIII presents a detailed analysis of the different methods employed by each of our nine groups of issue in the matter of raising and spending capital between 1927 and 1932. The group "Distribution," it is important to remember, here includes both "Transport" and "Entertainments" besides the narrower group called "Wholesale and Retail Distribution."

CONCLUSION

There emerge from our analysis of prospectuses four points which it would be possible for any Government to set right without difficulty, and without any confession that measures of socialisation are undoubtedly the best in the end. One is that much more detailed information is required about what is going to be done with the money that a company is trying to raise : the law in relation to the issue of prospectuses could, in this connection, be easily extended so that it would be made clear, and an estimate given of the direction in which all money raised would be spent. Secondly, it might with advantage be made illegal to issue an abridged prospectus. Either all the particulars required by law to be made known should be stated in the advertisement, or none of them. Abridged

prospectuses are apt to be so very misleading that it would be advisable to prohibit them altogether, and if a company wished to economise on its preliminary expenses to make it permissible to state barely that a certain issue was being made and that prospectuses could be obtained from a certain place. A third, and closely related, point is that new regulations are required to reverse the present habit of displaying on the prospectus in the largest possible type the name of a joint stock bank, and in the smallest possible type the name of the real issuer. This again is an objectionably misleading practice. Anyone studying a contemporary prospectus might be led to assume that the joint stock bank vouched for the issue, and also that company promoters were the most modest and retiring kind of people imaginable. The former assumption is quite untrue.

Finally, it is essential that steps be taken to organise some objective valuation of the assets of companies offering new issues to the public. The difficulty might be temporarily overcome by requiring the inclusion in prospectuses of certain particulars given in the published balance-sheets of the companies, in addition to a bare statement of their recent annual profits. This provision might not go far enough, for some companies run so many subsidiaries that their real position is masked. It is possible, when each company's individual balance-sheets are published separately, for the parent company to rate the shares which it holds in

its subsidiaries at an absurdly high value in relation to their real worth, and to include this inflated figure in its own balance-sheets. This would be avoided if it were made obligatory to publish an audited consolidated balance-sheet for the whole group.

FOOTNOTE TO RECENT CAPITAL ISSUES

THE SPARSITY of information given in the prospectuses analysed above obscures some of the analysis's value. Certain additional sample analyses, where greater details are obtainable, can elucidate further information with which gaps can be filled in. Two facts stand out from the analysis. First, of the amount of new capital subscribed through the new issue market, only a very small proportion can definitely be described as new capital. In 1931, for instance, more money was spent on floating new issues than was subscribed as new capital. The latter accounted for only one-third of 1 per cent of the total raised, while preliminary expenses absorbed one-half per cent.[1] In 1928, which marked the height of the new issue boom, new capital accounted for only 9·6 per cent of the money raised. The second outstanding fact is the complete absence of plan in the functional allocation of savings invested through the new issue market. Even a superficial examination of the categories grouped shows how little capital has been invested during the last few years in those depressed industries most needful

[1] When all Home Government and Overseas issues are excluded. Cf. Tables VII and VIII.

of fresh capital. A further more detailed analysis shows, for instance, that during 1928, 1929, and 1930, automatic machine companies took more fresh capital than cotton (which industry was in need of capital for reconstruction), the aggregate figures for the three years being £5 million for the former and only one-half million for the latter.

To ascertain exactly where the savings invested in the new issue market are disposed of, it is necessary to dissect where possible the amounts described in the above analysis as "Ambiguous." A further analysis of this item discloses the fact that the greater part of the capital raised for home industry through the new issue market is absorbed in buying out existing owners. The public provides the vendors with cash, acquires the assets, but more often than not leaves the original owners in control. In effect, a great number of capital flotations are the capitalisation at an enhanced figure of industrial profits which have been accumulated by private concerns and reinvested therein over a period of years. Such capitalisation on a fair basis could be quite legitimate, but careful investigation of new issues reveals that often they are a mere financial operation initiated, not by the industrialist in need of fresh capital, but by the financier who tempts the industrialist to capitalise his business, or to merge it with other businesses, in order that he can make promotion profits thereby. The usual procedure is for a financial group to offer the original owners

cash for part of their holding, shares in the new company, acquiring the old, for the balance, and a managerial contract at large salaries, as well as seats on the board. The vendor thereby does well out of the transaction, retaining his job at a high salary, keeping control through shares and directorships, while at the same time he has cashed in his profit and has money in the bank. To keep control in the vendor's hands, the public is invited to subscribe mainly to preference shares or debentures, and only to a small proportion of the ordinary, sufficient of these being retained by the financiers and vendors to give them a majority of the voting power. If the issue is a success, a portion of these ordinary shares may gradually be sold through Stock Exchange channels at inflated levels. It is not necessary to dwell here on the evils that result from this over-capitalisation, but figures given before the MacMillan Commission, and since brought up to date in the *Economic Journal*, reveal the large percentage of failures among new flotations and the heavy depreciation on their shares.

During 1928 the greater number of industrial issues were floated in this manner. They did not comprise new enterprises, but represented the sale of existing companies or the sale of a number of companies to a newly formed larger one, the money raised from the public passing, not into production, but into the hands of a few vendors, after paying the financiers' profits and flotation expenses.

To illustrate this I selected twenty-nine industrial concerns floated during 1928. These particular companies were chosen for no other reason than that it was possible to obtain from their prospectuses the details necessary for such an analysis.

These twenty-nine companies had an authorised capital of £12,337,500, of which there was issued £12,043,072. The public was invited to subscribe £8,611,375, and there was otherwise subscribed (through private placings by directors, friends, etc.) £1,235,000. A detailed analysis reveals that of this newly subscribed capital of £9,846,375, £7,498,983 was paid over in cash to the vendors, who, in addition, received shares free to a nominal value of £2,196,197. Percentagely this means that 76·16 per cent of the new capital subscribed in cash was absorbed in paying cash to the existing owners. Of the issued capital, only £2,347,892, or 19·59 per cent, remained after providing for the vendors. Out of this the expenses of formation had to be met. The money and shares paid over to the vendors, as far as is ascertainable, were on account of the following :

Property	£1,490,035
Fittings, Plant, etc. (omnibus item)	6,426,250
Plant and Fittings (specified)	789,971
Stock	1,069,289
Goodwill	1,512,992
Patents	348,500
	£11,637,037

In addition, there was a net indebtedness to be acquired by the new companies amounting to £549,304.

No claim can be made that this sample is representative of the total of industrial issues made, but it should be noted that these companies are those which published particulars of the use to which the capital was to be put, whereas in the majority of cases far less information is given. In any case, representative or not, these figures illustrate that through the new issue market large sums raised may have no effect on production or employment, nor in the case of the concerns examined, the majority of which were manufacturing for the home market, was production likely to be materially affected by the new financing.

This sample discloses the wasteful manner in which the savings of the public are used in the capital market. It reveals an abuse which only stringent control over the whole field of investment can eliminate. A National Investment Board, responsible for new investments, could not sanction any issues made for the purpose of buying out existing holders, unless it could be shown in the first place that it was in the interests of economy and efficiency that change of ownership should take place in this way ; and, secondly, that the acquisition was taking place on a basis of fair valuation based on past, and not estimated future, earnings, and on current values fixed by independent valuers and not by prospective sellers.

Further, full detailed information of the value of all assets to be acquired would have to be published, meaningless omnibus items, including the abbreviation, etc., which covers goodness knows what, being eliminated. The National Investment Board should have the final say as to the basis of payment to the vendors. The board would decide how much in cash and how much in shares should be received, and its decision should be based on a formula which would have regard to the amount of capital originally invested in the business by the vendors, and the amount of profits reinvested therein, and also perhaps the capitalised value of the annual profits. New issues of this nature, however, would become less as the scope of the National Investment Board was extended, any change of ownership eventually being not from one set of private owners to another, but from private to public ownership. Control of new issues of this type is likely quickly to be found essential immediately a Socialist Government assumes office, as the fear of compulsory State interference and acquisition can easily lead to a desire on the part of private owners to make sure of their profits by capitalising their business and turning their wealth into a more liquid and mobile form.

INSURANCE COMPANIES AND INVESTMENT TRUSTS

FRANCIS WILLIAMS
City Editor of the *Daily Herald*

INSURANCE COMPANIES AND INVESTMENT TRUSTS

THE MERE FACT of size has come in the modern world to be regarded as in itself significant, though of what it is significant is not always clear. But the great insurance companies and investment trusts of the City of London have in real fact a significance beyond that of size alone. They represent two distinct and highly important phenomena of our economic system—the anxious search for security by the ordinary man frightened by the insecurities which surround him, and the domination of vast sums and great organisations by a few men.

The appeal of both types of institution to those who participate as shareholders or policy-holders is the assurance of a safety impossible for the individual to attain, and the financial influence of both is due to the centralised control of the savings—often the individually small and financially unimportant savings—of many thousands of people. In both, also, the divorce between ownership and control which is increasingly characteristic of large-scale joint stock enterprise is almost complete. The shareholder in an insurance company or investment trust has practically no voice in the investment policy of his company. The

insurance company policy-holder, who provides an infinitely larger portion of its funds than the shareholder, has none. It would, indeed, be impossible for him to have any effective or intelligent voice in such policy, and I mention the fact that he has none, not in criticism of the companies, but rather as a reminder that ownership and control need not by any means be synonymous in the modern world—a reminder which is particularly valuable for Socialists to keep in mind.

The exact position of the insurance companies in a Socialist State is not easy to determine, for many of the ills they provide against are native to capitalism and might be expected to disappear under Socialism, and many of the fears they assuage—such anxieties, for instance, as those regarding the future of dependants in the event of the wage-earner's death—would be removed by a Socialist State.

Moreover the insurance companies cover a wide range of business, both national and international, some of which, such as life and industrial assurance, lends itself easily to State control, while other sections, and particularly the foreign business which accounts for between 75 and 80 per cent of the fire and casualty premium incomes of the British offices, do not.

And again, even in life business the differences in the premium rate charged by the offices and the position of the companies dealing in very selected lives creates a number of complications which need the most careful

consideration before any complete scheme for national control under, for example, a public corporation can be formulated.

It is, however, not so much the Socialist policy regarding the business conducted by the insurance companies with which I am here concerned as with their functions as investors of a substantial proportion of the national savings.

Insurance is to-day one of the greatest of national industries, for, as has been well stated by the *Economist* in a recent insurance supplement, "the capital and money markets, the Stock Exchange, constructional industries, and, last but not least, an important part of our 'invisible exports'—all these depend to a great extent upon this one industry. The nation's attitude to saving is here given practical expression, and the industry canalises the results of that attitude."

It is, as stated, with the function of the insurance companies as investors of the savings thus canalised that I am mainly concerned here, and that function may indeed, I think, be regarded as of the most immediate importance from the point of view of public policy. Apart from the 156 registered collecting societies of Great Britain, there are, according to a recent chart issued by the Corporation of Insurance Brokers, 130 insurance companies in existence covering business ranging from life assurance business, which is itself divided into at least 15 different categories, to all types of casualty and other insurances

covering altogether 56 different sections excluding marine business.

These companies, most of which are of some considerable size and importance, have a total paid up capital in excess of £45 million, and shareholders' funds of more than £12 million. Their insurance funds, which belong to, or are held in security for, policy-holders, exceed £1,000 million. It will be seen, therefore, that share capital, though considerable, is relatively unimportant compared with the total assets of the companies, and, indeed, there are a number of companies, including at least 15 well-known and important ones, which have no share capital at all, being what is termed mutual offices. Even in those companies which have shareholders the share capital is frequently, and, indeed, usually, infinitesimal compared with the total assets.

Thus, for example, the Prudential, the largest insurance company in the world, with total assets amounting to £277,472,181, has a paid up capital of only £1,450,000—on the majority of which, incidentally, a dividend of 92 per cent was paid last year. It is from their administration of policy-holders' money, not shareholders' money, that the insurance companies derive their investment importance, though it may be noted in passing that the dividends paid on insurance shares have shown a steady advance over a period of years, while shareholders have also enjoyed substantial capital appreciation, it being generally estimated by

investment authorities that a good insurance share will appreciate by at least 25 per cent in five years, and possibly by as much as 50 per cent. The result of this is that, despite the high dividends paid, the yield on investment shares at the price they can be bought in the market is low.

The £1,000 million of policy-holders' funds commanded by the insurance companies is invested as to about 60 per cent in Stock Exchange securities, and about 40 per cent in mortgages. It is not easy to obtain exact figures of the total amount of annual savings which are canalised in the insurance companies and invested by them, but it was recently estimated by Mr. Colin Clark that approximately £50 million was probably saved each year through the medium of the insurance companies. A large proportion of this represents the savings of many hundreds of thousands of people who—particularly in so far as industrial assurance is concerned—probably have no other form of saving. To that extent the funds of the companies consist of money which would not otherwise be invested. But there is also a substantial proportion in the ordinary life business which consists of funds which would otherwise be directly invested by individuals themselves—some ordinary life premiums, for example, running into many thousands of pounds annually. There is also a growing tendency, evidenced by the popularity of endowment policies, to regard insurance, not simply from its original standpoint as

a life cover, but as an investment. The advertisements of the companies increasingly stress this side of the matter, and the companies may now be regarded as making a dual appeal, the attraction they offer being partly that of providing insurance cover, and partly that of investment trusts. To the extent that this second appeal operates, the funds of the insurance companies represent money diverted from other investment channels, whereas the small industrial premium payments, and probably a high percentage of medium size ordinary life premiums, represent savings which would not otherwise be made. Money invested with the companies to purchase life annuities can, on the other hand, generally be taken as money which has been withdrawn or diverted from the usual investment market.

The growth in insurance funds since the war can, I think, be best illustrated by the combined experience of four leading companies mainly transacting life business—the Prudential, the Pearl, the Alliance, and the Sun Life Assurance Society. The table opposite gives a summary of the combined funds, capital reserves, and invested assets of these companies at December 31, 1920, and December 31, 1933, the last year for which complete figures are available.

The remarkable growth of invested assets and the amount of new money they have regularly available for investment do not—considerable though they are—account entirely for the investment influence of the

SUMMARY OF THE FUNDS, CAPITAL AND RESERVES, AND INVESTED ASSETS OF FOUR LEADING INSURANCE COMPANIES MAINLY TRANSACTING LIFE BUSINESS

Figures are as at December 31, 1920 and 1933

	1920		1933		Increase	
	£	£	£	£	£	£
Capital issued and paid-up	3,180,250		4,430,000		1,249,750	
Free Reserves and Profit balances	6,844,350	10,024,600	23,433,900	27,863,900	16,589,550	17,839,300
Funds: General Life and Annuity	98,396,000		203,310,000		104,914,000	
Industrial Life	68,381,250	166,777,250	179,779,100	383,089,100	111,397,850	216,311,850
Other Business, Fire, etc.		7,678,900		15,144,900		7,466,000
		184,480,750		426,097,900		241,617,150

assurance companies. The assurance companies are among the most expert investors in the world, and as such, in the Stock Exchange phrase, "keep their investments moving." It has, indeed, been estimated by one Stock Exchange authority that the turnover of securities by the assurance companies is in the neighbourhood of £500 million a year. While this is possibly an exaggeration, and clearly cannot be confirmed in any way, the companies do undoubtedly turn over their investment holdings very frequently. As a result they bring an enormous amount of grist to the Stock Exchange mill, and obtain a corresponding amount of influence in City affairs.

Their influence in industrial matters, which is now frequently substantial, has been increased in recent years by a new tendency in their investment policy illustrated in the table opposite, which shows the distribution of the invested funds of the four leading companies previously referred to at the end of 1920, and again at the end of 1933.

It will be seen that these four companies have a higher percentage of their assets invested in Stock Exchange securities, their percentage being approximately 78 per cent as against a general estimated average of 60 per cent.

The figures of these four companies are probably roughly typical of a tendency of the insurance industry generally towards a considerable broadening of investment policy since the war. Not many years

INVESTED FUNDS

	December 31, 1920		December 31, 1933		Increase	
	Amount	per cent of Total	Amount	per cent of Total	Amount	per cent
	£		£		£	
MORTGAGES :						
U.K. and Irish Free State	13,550,100 ..	7·49	19,530,800 ..	4·69	5,980,700	30·62
Foreign	199,200 ..	·11	6,292,300 ..	1·51	6,093,100 ..	96·83
Loans on Rates, Policies, etc.	19,412,500 ..	10·73	43,769,100 ..	10·52	24,356,600 ..	55·65
INVESTMENTS :						
British Govt. and Municipal	83,650,800 ..	46·22	145,877,800 ..	35·05	62,227,000 ..	42·66
Indian and Colonial Govt. and Municipal	13,472,200 ..	7·44	34,420,500 ..	8·27	20,948,300 ..	60·86
Foreign Govt., etc.	11,953,700 ..	6·60	22,255,700 ..	5·35	10,302,000 ..	46·29
Debentures, Railways, Industrials, etc.	15,089,700 ..	8·34	62,488,300 ..	15·01	47,398,600 ..	75·85
Preference Shares and Stocks	4,044,700 ..	2·23	27,093,000 ..	6·51	23,048,300 ..	85·07
Ordinary Stocks and Shares	4,269,800 ..	2·36	32,177,800 ..	7·73	27,908,000 ..	86·73
Property, Ground Rents, etc.	13,975,000 ..	7·72	19,615,700 ..	4·71	5,640,700 ..	28·75
Investments in Sub. Cos., Reversions, etc.	1,377,600 ..	·76	2,707,400 ..	·65	1,329,800 ..	49·12
	180,995,300 ..	100·00	416,228,400 ..	100·00	235,233,100 ..	56·52
Difference represents surplus of Cash and Debtors over Creditors	3,485,450		9,869,500		6,384,050	

ago only a negligible proportion of their funds invested in Stock Exchange securities were in other than gilt-edged and near gilt-edged stocks. It will be seen, however, that, in the case of these four companies, investments in debentures, preference and ordinary shares and stocks has risen from only 12·93 per cent at the end of 1920 to 29·25 per cent at the end of 1932. This section shows the largest percentage increase with the exception of that consisting of mortgages abroad, which latter is probably attributable to exceptional circumstances, for it represents to a considerable extent the making up of leeway lost during the war, which precluded expansion in this direction. It is thus impossible to say whether the expansion in foreign mortgage investment is normal or abnormal, though it is certainly striking, but as regards the investment in industrial securities we are on safer ground, for the increase in this section of investment is certainly due to a deliberate and generally recognised policy change. It coincides, as one would naturally expect, with a diminution in the rate of increase of investment in safety-first securities such as British Government stocks, corporation securities and property.

This movement towards higher yielding if somewhat less safe securities is due mainly to increased competition in life assurance business, which has forced the companies to make policies and premiums more and more attractive. This has been done either by the reduction of premiums, or, more commonly, by higher

rates of bonus or with profit policies. As income from investments is the main source of the companies' profits, securities offering higher yields have had to be sought, though the British companies have always, to their credit, remembered that safety is the main essential for an insurance company investment, and have never gone into ordinary stocks and shares to the extent of some of the American and Canadian companies, who have found it impossible during the stock market depression to put their investments in their balance-sheets at anything like their market value, because to do so would have been to confess to virtual —though no doubt only temporary—insolvency.

The investment practice of all the British companies is not of course identical, but the belief that the four leading companies are roughly typical of general practice is supported by the fact that a classification of the assets of thirty-nine assurance companies compiled by the *Economist*—which, however, unfortunately only goes back to 1930 compared with our comparison of the development since 1920—shows 27·7 per cent of investments in debenture, preference and ordinary stocks in 1932.

This tendency has probably been checked somewhat during the last two or three years, owing to the fall in industrial security values and the rise in the market value of British Government stocks, but it is likely to be resumed if and when industrial markets show an indication of reasonably steady improvement. It may,

indeed, be accelerated in consequence of the reduced yield obtainable in Government, municipal and other fixed interest securities.

When we turn from insurance companies to the other great group of institutional investors, the investment trust, the task of determining both the volume and distribution of their funds is more difficult.

The table opposite gives, however, a summary of the capital structure of most of the companies whose stocks are quoted on the London Stock Exchange, that of 169 companies having been analysed and co-ordinated. In this case the amounts which have been raised by the trusts in various classes of capital are set out; and the total amount paid out in dividend or interest, and at what percentage rate, given. The average capital of these 169 companies is £1,656,805.

These figures do not include the capital issues of a fairly large number of Scottish companies, which will probably amount to between £25 million and £30 million. To arrive at the total invested funds at book costs—which may, of course, be very different from nominal values, and even more different from market values, which it is impossible to estimate accurately owing to the lack of detailed information regarding trust holdings—allowance must also be made for reserves and undistributed profits. These, at 10 per cent of capital—a reasonable basis to take—would, allowing for a total capital of, say, £310 million—English companies £280 million, Scottish

SUMMARY OF INVESTMENT TRUSTS' CAPITAL STRUCTURE

COVERING MOST COMPANIES WHOSE STOCKS ARE QUOTED ON THE LONDON STOCK EXCHANGE

	Capital		per cent of Total		Dividend and Interest		
ORDINARY		£78,220,000		27·94		£3,911,000	Estimated at 5 per cent
PREFERENCE	£				£		
at 4 per cent	8,526,000		8·80		341,040		
4¼ per cent	2,035,000		2·10		86,487		
4½ per cent	16,433,000		16·97		739,485		
5 per cent	52,253,000		53·99		2,612,650		
5¼ per cent	750,000		·77		39,375		
5½ per cent	7,942,000		8·20		436,810		
6 per cent	4,841,000		5·00		290,460		
7 per cent	3,198,000		3·30		223,860		
10 per cent	847,000		·87		84,700		
		£96,825,000	100·00	34·58		£4,854,867	Average rate = 5 per cent
DEBENTURES							
3½ per cent	2,748,000		2·62		96,180		
4 per cent	27,513,000		26·21		1,100,520		
4¼ per cent	6,550,000		6·24		278,375		
4½ per cent	16,567,000		15·78		745,515		
Terminable (say)							
4½ per cent	7,815,000		7·45		351,675		
5 per cent	43,762,000		41·70		2,188,100		
		104,955,000	100·00	37·48		4,760,365	Average rate = 4½ per cent
		£280,000,000		100·00		£13,526,232	

companies £30 million—equal about £31 million. We thus arrive at total invested funds of anywhere between £340 million and £350 million, while allowance must also be taken for bank loans and deposits, which should easily exceed £10 millions, thus making anything up to £360 million.

The investment trusts thus command investment funds totalling just over a third of those possessed by the insurance companies.

It is impossible to give any reliable estimate of the percentage distribution of the investment trust funds among various classes of securities, as only a few of the trusts give a list of their securities, but certainly the major proportion of these funds is invested in securities quoted on the Stock Exchange, and a very much smaller percentage is invested in British Government securities than in the case of the insurance companies.

Although the investment trusts command smaller funds than the insurance companies their influence in the City is no less, and may be even greater, for the reason that the investment trusts follow, if anything, a more active policy. Moreover, while none of the trusts approach in size even the medium-sized insurance companies, most of them belong to groups each member of which is controlled by practically the same directorate.

The best-known and most powerful groups are the St. Davids group, headed by Lord St. Davids, who is

chairman of fourteen trust companies; the group controlled by Sir George Touche, who is chairman of nine trusts; and the Brown Fleming & Murray group, headed by a Glasgow firm of accountants of that name, which consists of fifteen companies. The last two groups are headed by chartered accountants.

In addition to the well-established management trusts there have recently been started here a number of fixed trusts. These trusts are patterned on an American model, and are restricted in their investments to a group of securities announced at the time of the trust's formation. A unit of the trust will consist of probably twenty or twenty-five blocks of shares. The units are then divided into sub-units, which are offered to the public.

A typical holding is given on the following page, which forms Unit B of the National Fixed Trust.

In this case each unit is divided into 4,800 sub-units, which can be subscribed for by the public. The market value of the sub-unit fluctuates with the Stock Exchange prices of its component parts in much the same way as an index number.

The idea of these trusts is to keep the investment trust appeal of a spread of investment risk while removing any danger of loss through unwise management of funds on the part of the trust directors. They were, as indicated, originally started in the United States, where investors had much more reason than those in this country to suspect not only the wisdom,

No. of Shares	Security	Approximate percentage invested in each Group
	Commodities :	26
100	Manbre & Garton Ltd., ordinary shares	
1,200	Maypole Dairy Co. Ltd., deferred ordinary shares	
£100	Spillers Ltd., ordinary stock	
50	Tate & Lyle Ltd., ordinary shares	
150	Unilever Ltd., ordinary shares	
	Oil :	4½
£50	Burmah Oil Co. Ltd., ordinary stock	
	Tobacco :	6½
£50	British-American Tobacco Co. Ltd., ordinary stock	
	Mining and Finance :	9
200	Burma Corporation Ltd., shares	
100	Johannesburg Consolidated Investment Co. Ltd., shares	
	Transport and Communication :	22
£500	Cables & Wireless Ltd., 5½ per cent cumulative preference stock	
100	Fairey Aviation Co. Ltd., ordinary shares	
200	Furness Withy & Co. Ltd., ordinary shares	
£500	Great Western Railway Co. consolidated ordinary stock	
	Miscellaneous :	32
£50	J. & P. Coats Ltd., ordinary stock	
100	Distillers Co., Ltd., shares	
150	Imperial Chemical Industries Ltd., ordinary shares	
50	London Brick Co. & Forders Ltd., ordinary shares	
50	Michael Nairn & Greenwich Ltd., shares	
50	Radiation Ltd., ordinary shares	
£100	Watney Combe Reid & Co. Ltd., deferred ordinary stock	
		100

but sometimes the honesty, of investment trust managers.

They have proved very popular here, but it seems unlikely that they will play quite so large a part in any financial structure as in the United States. Their investment policy is, of course, by the nature of their constitution inactive, as the securities which make up the units can only be sold in certain special circumstance. Nevertheless, the inclusion of the same industrial securities in the portfolios of a number of these fixed trusts means a steady demand for certain shares which may have the result of forcing such shares to artificially high levels. Similarly, if anything happens to make it necessary to remove such shares from the portfolios, selling by fixed trusts all at the same time may precipitate or exaggerate share declines.

The influence of the management investment trust has recently been increased by the formation of an Investment Trusts Association which has at present 195 members, with a total issued capital of £310,621,000. Members of the Association act together in cases where they consider that investment principles, important to them, are affected by a company's decision.

While they and the insurance companies wield very great influence, it would of course be a mistake to regard them as all-powerful. Thus, in a recent case where directors of the Union Cold Storage Company

proposed the reduction of preference stockholders' interest rates in return for a cash payment provided by the ordinary shareholders, both the Insurance Companies Association and the Association of Investment Trusts opposed the scheme, and publicly announced their opposition.

Yet, despite this, the directors not only continued with this scheme, but carried it on a preference stockholders' vote, although it is true the question of the validity of the offer was later carried to the law courts.

Nevertheless, although they are not omnipotent, the insurance companies and investment trusts together do wield very considerable power. The fact that they jointly control at least £1,350 million of investment capital might be regarded as alone sufficient to account for that.

But in actual fact their £1,350 million of invested funds, of which probably round about £950 million is invested in Stock Exchange securities—though enormous enough in all conscience—is but a flea-bite compared with the total value of Stock Exchange quoted securities. Thus the nominal value of securities quoted in the Stock Exchange Official List alone was at December 31, 1933, £18,475,954,914, while in addition there are a large number of securities quoted in the Supplementary List. Their real power comes from the fact that in a largely unorganised world they are highly organised.

The development of large joint stock enterprises and the spread of the habit of share investment among people of moderate means have together combined, in a very large number of cases, to rob the owners of capital of any effective voice in control, simply because they are frequently so numerous and so scattered that it is practically impossible to obtain any co-ordination among them, as anyone who has had to organise shareholders to protest even against an especially blatant or even fraudulent infringement of their rights or mismanagement by directors knows from sad experience.

An industrial company may have many hundreds, or even thousands, of shareholders, many of whose interest is relatively only small, while all but a few are both ignorant of company procedure and too busy with their normal occupations to devote much active intelligent interest to proposals which may be put forward by the directors. Only a tiny minority commonly have the time, inclination, and money necessary to attend an annual meeting, which is probably held in London, and attendance at which would possibly mean considerable travelling and an interruption of ordinary business. Those who cannot attend and vote at the meeting can, it is true, vote by proxy, but unless there is any organised opposition they only receive proxy forms in favour of the directors, and a large number automatically sign these. Those shareholders who feel actively antagonistic to the

directors' proposals, or who are dissatisfied with the management, can usually do nothing more effective than abstain from voting.

In such circumstances the ownership of even a comparatively small block of shares in a company frequently gives an investment trust an influence out of all proportion to the actual holding, simply because the trust is in a position, which the majority of individual shareholders are not, to fight for what it conceives to be its rights, and can provide a rallying-point for disgruntled shareholders who would otherwise be leaderless. Moreover, it is able to put against the prestige which the directors often possess in the eyes of shareholders as the men in control an equivalent, if not greater, prestige as an investment authority. For these reasons, the worldly-wise directorate of a company whose shareholders include one or more of the investment trusts not unnaturally regard it as politic to keep friendly with the trusts, and to consult them in advance regarding any proposals for policy alteration or reorganisation before putting their proposals to the general body of shareholders. In this way the investment trusts and also the insurance companies—whose influence in this direction is increasing as their holding of industrial shares grows—have a considerable voice in industrial policy, particularly when, as now, times are bad and a number of companies find it necessary to pass not only ordinary but preference dividends, to ask for

moratoria on their debenture stock, or to reconstruct their capital.

Moreover, the insurance companies and investment trusts occupy a key position in the new issue market.

They very frequently are prepared to take up, without the preliminary of a public issue, large blocks of securities which are afterwards introduced on the Stock Exchange, through the medium of a formally advertised offer for sale. In addition, they are large regular underwriters of public issues of sound securities. The acceptance of underwriting by insurance companies and investment trusts may indeed be regarded in many cases as an essential preliminary of a public issue, with the natural consequence that they have a considerable voice in the capital structure and organisation of the companies concerned.

Moreover, some of the big insurance companies—notably the Prudential—and to a lesser extent the investment trusts, have developed considerably a form of private financing which helps to fill the gap which at present exists in the financial system between the short-term financing provided by the joint stock banks and the long-term financing provided through the medium of a public issue.

Thus, by advances secured on property or plant, they enable a company in the early stages of development to obtain finance which it would be difficult to raise through other channels. The motor industry and chain stores specialising in low-price goods are two

notable instances in which finance has been very usefully provided in this way by the Prudential Assurance Company. Other insurance companies have assisted similar developments. Recently they have been particularly active in financing property companies.

It will be seen, therefore, that the insurance companies and the investment trusts fill important functions within the existing financial system, both as mediums through which the ordinary person can obtain greater security for savings than would otherwise be possible and as architects in some degree of industrial policy. The security they offer is, of course, limited. They can eliminate some of the risk of investment by expert management of funds and by spreading their holdings over many classes of securities, both at home and abroad, but they do not provide any security against the effects of a collapse in security values due to general economic depression, although the insurance companies, helped both by sound management and by the improvement in the average lives of assured people, have provided so far a very efficient buffer between the small saver and depression. The investment trusts have not been so successful, for the factor of improved health which has helped the insurance companies does not of course assist them, but even they have undoubtedly, in the majority of cases, given the investor greater stability, both of capital and of income, than he would have obtained by investing on his own account.

Their function in a Socialist State is hardly likely to be so important as at present, both because some of the insecurity against which they provide will have been removed by a more ordered planning of the industrial system; and also because some of their investment functions will be taken over by State bodies such as the National Investment Board. From the national standpoint, the insurance companies are certainly to be regarded as the more important of the two, both because of the social function they perform and because they are the agents for the investment of a much larger volume of regular annual savings than are the investment trusts.

The nationalisation of insurance as insurance, apart altogether from the important investment functions of the companies, is a part of Socialist policy, and there is indeed no sound argument for the continuation of share capital as it is at present. To quote the report of the recent Treasury Committee on Industrial Assurance and Assurance on the Lives of Children under Ten Years of Age: "The capital of a well-established industrial assurance company is of no material advantage to the policy-holders." The same is true of the ordinary life companies.

In such circumstances, the continued payment of high dividends to shareholders who perform no useful function cannot be justified. The national control, certainly of industrial and life assurance, at a fairly early state, and ultimately of all insurance business,

by the formation of a public corporation to take over the business of the present companies, with compensation for existing shareholders on a fair basis, must therefore be regarded as an essential Socialist measure.

The relationship between the National Insurance Corporation and the National Investment Board will obviously be very close. Insurance funds, representing, as they do to so large an extent, the small savings of workers, ought clearly to be utilised in ways which will be of benefit to them in helping to create employment and improve industrial standards. In this connection, the substantial amount of insurance funds invested abroad—although some are a direct consequence of foreign insurance business carried on by the British companies—seems to need consideration. It may be necessary for the National Investment Board substantially to restrict this foreign investment and to divert the savings to purposes of greater national benefit than those investments can be shown to offer.

Security for the policy-holder will, of course, remain a primary consideration in deciding on investment policy.

Incidentally, the influential position of the insurance companies in relation to many industries might be used effectively to speed up national industrial reorganisation, while the investment experts of the insurance companies should provide extremely valuable

personnel for the National Investment Board. It does not seem likely that a national corporation would find much necessity for disturbing the present investments of the insurance companies with the possible exception of some of their foreign holdings, but control of the direction of their new investments would form part of the general policy of the National Investment Board, whose main function it would be, by the control of new capital issues and private financing of a capital character, to ensure that national savings were directed into the channels most to the national advantage.

The place of the investment trusts is not so clear. They are essentially the products of a system of private capitalism, and their function of discriminating for the private individual between sound and unsound undertakings will, so far as new issues are concerned, be performed by the National Investment Board. They do not provide a regular channel for new savings to anything like the same extent as the assurance companies, their direct absorption of national savings depending upon their new capital issues. It is difficult to obtain an exact estimate of the average total amount of new investment trust issues each year. The following table gives, however, new capital issues for financial, land, and investment trusts each year since 1920, as compiled by the Midland Bank, but only a proportion of this money was, of course, for investment trusts proper :

1921	£2,676,000
1922	9,598,000
1923	7,237,000
1924	17,229,000
1925	21,595,000
1926	33,068,000
1927	46,214,000
1928	68,707,000
1929	44,836,000
1930	12,473,000
1931	8,194,000
1932	3,687,000
1933 (10 months)	7,994,000

It will be seen that the new capital raised fluctuates very considerably from year to year. The figures are, incidentally, also interesting as evidence that the trusts make the common mistake of raising most money during a boom period, whereas actually it would seem that they could employ funds most profitably by the purchase of securities at abnormally low levels during a depression. In addition to the increase in their resources through the direct raising of new capital, the investment trust funds show under good management a fairly steady expansion in consequence of their distinctive policy of not distributing to their shareholders profits made by buying and selling securities, but only the income received from their holdings.

This expansion may be regarded as an indirect absorption of national savings, seeing that if the trusts buy a security at, say, £100, and sell it at £110, they have attracted to themselves that percentage of investment money which they will of course later reinvest.

Even if they were otherwise uncontrolled, new capital issues by the investment trusts would be dependent upon the approval of the National Investment Board, and that approval in its turn should be dependent upon a statement from the trust as to the directions in which it was proposed to reinvest the new money. It would seem essential, also, that the investments of the trusts should be subject to periodic inspection by the National Investment Board, so that they could be compelled to follow the general lines of policy laid down by it. This is particularly important as regards foreign investment, which is especially popular with a number of investment trusts, some of whom exist mainly for that purpose.

A ban on foreign issues is not alone sufficient to check the export of capital by the investment trusts—and this applies also to the insurance companies—because they largely purchase existing securities quoted on foreign markets. Control of the foreign exchange market, which may in any event be necessary, even if only as a temporary measure, upon a Socialist Government taking office, could, however, effectively prevent any attempt to export capital to a large extent.

While control of the direction of the investments of the trusts is in any case necessary as part of sound financial planning, it might be desirable to absorb them even more completely in the National Investment Board. This depends to some extent upon

whether the board—which is discussed in greater detail in another section in this volume—is to be exclusively a controlling body or is itself to issue bonds and finance industrial developments. In the latter case, the investment trusts might well be absorbed and merged into one National Investment Trust, forming, indeed, the nucleus of that department of the National Board's activities. In such an event, existing shareholders would receive stock of the national trust in return for their present holdings. Such a transaction would be facilitated by the fact that, as reference to an earlier table will show, the major proportion of the investment trust's capital has been raised in the form of fixed interest securities.

Both the insurance companies and the investment trusts represent to some extent an effort to plan the investment of community savings. The absorption of their functions into those of a National Investment Board is thus a logical development, for the National Investment Board will exist to plan the investment of community savings for the public good on a scale hitherto unattempted and, indeed, unobtainable within the limitations of competitive capitalism.

BUILDING SOCIETIES

E. S. WATKINS, LL.B.

BUILDING SOCIETIES

Building Societies are organisations which, since the war, have played an increasingly important part in the economic structure of the country. That part is a double one: as instruments for the collection of national savings, and as instruments for the finance of the construction of new houses.

The method by which that portion of the national income which is "saved" is in fact saved is to a certain extent disputed by economists. Dealing with home investments, there are four principal channels through which these savings are collected. They are:

(1) Undistributed profits of companies.
(2) Increase in assets of insurance companies.
(3) Increased surplus in savings bank.
(4) Increased surplus in building societies.

It is not possible within the scope of this article to go into the details of the conflicting theories, but the following table, taken from Mr. Colin Clark's *The National Income, 1924–1931*, gives an estimate which, if not necessarily completely accurate, illustrates in general the tendencies referred to above.

CONTRIBUTORY ITEMS TO THE TOTAL OF SAVINGS

Figures in £ million

	1924	1925	1926	1927	1928	1929	1930	1931
Undistributed profits	167	162	128	186	168	169	134	131
Deduct losses and dividends (if any) of concerns making losses	−9	−17	−19	−20	−14	−16	−46	−78
Net surplus realised out of taxation, etc., by State, L.A.s and insurance funds	81	71	56	116	106	71	35	25
Capital outlay on roads not met by loans	15	17	17	18	17	18	18	20
Increase in liabilities of:								
Insurance companies	42	53	52	49	50	49	41	50?
Building societies	19	24	23	28	44	43	56	43
Savings banks	11	9	−2	4	11	0	12	?
Home investment (after meeting depreciation)	218	459	240	215	214	168	127	145
Total investment	292	513	264	332	358	293	183	43

This development is illustrated in perhaps a more static way by the following table, taken from an article on "Building Societies" by Sir Harold Bellman, Chairman of the Abbey Road Building Society, in the *Economic Journal* for March 1933:

AMOUNT DUE TO INVESTORS IN VARIOUS THRIFT ORGANISATIONS

Description	1918	1930	Percentage increase
	£ million		
Building Societies	64·2	353·6	451
National Savings Certificates	137·7	358·0	160
Post Office Savings Bank :			
Deposits	234·6	290·2	24
Holdings of Government securities	185·7	188·5	2
Trustee Savings Banks :			
Ordinary Department	61·0	79·0	13
Special Investment Department	14·1	54·1	284
Holdings of Government Securities	15·3	39·3	157

In short, therefore, we may say in general that during the last ten years the proportion of savings made through building societies has increased until in 1930 it accounts for practically one-third of home investments. The magnitude of the proportion demands that building societies should receive rather more attention than they have hitherto.

Linked with the activities of building societies as instruments of saving is a corresponding function as instruments for the finance of house purchase, for in general it may be said that the whole of the money invested through building societies goes almost immediately and directly into the finance of house purchase.

Here again it is perhaps hardly the place to attempt any detailed analysis of the exact proportion of the

total money used in the construction of new houses that building societies provide. We may, however, accept as fairly authoritative the estimate by Sir Harold Bellman in his article published in the *Economic Journal*. Taking the total of new houses erected since the war in England and Wales as being two million, he estimates that about one half had been financed through the agency of building societies. This position is very different from the position before the war, as the following table, taken from his article, will show :

BUILDING SOCIETY ADVANCES IN RELATION TO NEW HOUSES

Year	New Houses [1]	Building Society Advances (£ million)
1902	133,000	8·9
1903	121,000	9·7
1904	127,000	9·4
1905	132,000	9·0
1906	145,000	9·2
1907	112,000	9·6
1908	101,000	8·9
1909	97,000	9·0
1910	102,000	9·3
1911	36,000	8·9
1912	92,000	8·3
1913	60,000	9·1
1924	74,000	40·5
1925	121,000	49·8
1926	135,000	52·1
1927	149,000	55·8
1928	140,000	58·6
1929	119,000	74·7
1930	146,000	88·7
1931	135,000	90·2

[1] The statistics from 1902 to 1913 show the net annual increase in the number of dwellings in England, Wales, and Scotland disclosed by the reports of the Inland Revenue Commissioners : the statistics from 1924 to 1931 show the number of houses erected by the private enterprise in England, Wales, and Scotland.

While there is not necessarily any direct connection between the two sets of figures, they do illustrate quite clearly that building societies have played an enormously increased part in the finance of new housing.

Socialisation, because it involves a change in the purpose for which the economic machinery is used, must deal with the whole of the economic machinery in use within the State. Furthermore, it must make use of all machinery which can be adapted to its purpose. To complete these rather axiomatic statements, the first business of a Socialist Government must be to take possession of the motive force in industry—namely, credit. Having regard to the large and increasing part which building societies are playing in the provision and manipulation of credit, it does seem essential that Socialists should know, not only what they are going to do with banks, but also what they are going to do with building societies.

I. DEFINITION OF BUILDING SOCIETIES

Building societies, as defined by the Chief Registrar of Building Societies, are societies established under the Building Societies Acts, and their function is to "assist their members in acquiring dwelling-houses, business premises, or other freehold or leasehold property, for occupation or investment. Members' subscriptions to share capital are accumulated in a fund which may be augmented by deposits and loans, and

advances are made from it to assist members in the purchase of properties. Security for advances is given by a mortgage upon the property purchased."

2. HISTORICAL SURVEY

The earliest building society is reputed to have been founded in Birmingham in 1781. Like many other institutions, their functions have changed considerably since their inception.

The original motive behind the creation of building societies was political. In 1781 the "Forty-shilling franchise" still existed; the right to vote depended upon the ownership of land, and building societies were designed to secure for the middle classes a vote which they would not otherwise gain. In brief, the building society was an association of individuals who desired a vote, and formed a society to buy land in bulk, to divide it up into plots of the annual value of not less than forty shillings each, and to transfer these plots to the individual members. It was a complicated method, but was it necessary for two reasons.

The first lies in the complexities of the system of land transfer then existing. The modern form of transfer of land did not then exist, nor was it easy for a small Birmingham craftsman to persuade the local landowner to sell him just enough land to enable him to qualify for the vote.

But the more important cause lies in the question of the cost of land. Building societies originated in an

age when the lottery still flourished, when chance was not confined to horse-racing and dog-tracks. It was difficult for one man to find the £100 necessary to buy the field that would give him the vote. But if he joined with his friends in putting up £10 each, the field could be bought. And if the ten were quite prepared to cast lots among themselves to determine who should be the owner of the field they had collectively bought, and who should secure the vote, the society had achieved its purpose. It continued. Each member continued to subscribe each month, and more land could be bought till all were satisfied. Then the society died. Its function was exhausted.

The political purpose of building societies vanished with the extension of the franchise, but the idea of the collective subscription of money to enable each member in turn to purchase the land or house he desires remained, and gradually the purpose of the societies changed from associations of individuals acquiring land for the political advantages that flowed from its ownership, to associations of individuals who desired to acquire houses in which to live and who were prepared to pay monthly subscriptions in the hope that they would be lucky in the ballots for advances.

3. CLASSIFICATION OF SOCIETIES

Building societies can be divided into two groups : (*i*) Terminating societies, (*ii*) Permanent societies.

Permanent societies now form by far the largest

group, but, inasmuch as terminating societies form the older historical group, and present more variety, it may be more convenient to consider them first.

(*i*) *Terminating Societies*

These are societies which terminate on a fixed date or on the happening of a certain event, which may be when each member has received the advance to which his share entitles him.

In general, their characteristics are these. A certain number of individuals resolve to form a society. The number of shares in each society is usually limited, and ownership of a share (*a*) involves the payment by the owner of a fixed weekly or monthly sum to the society, and (*b*) entitles the owner to a fixed advance from the society.

They may be further sub-divided into :

(1) Societies making advances free of interest. There are two classes of society in this group :

(*a*) The " Ballot and Sale " societies. These originally formed a large proportion of all societies, but no new ones can be established since the Act of 1894. The method is that the right to an advance of money from the society is balloted for or auctioned among members—usually the latter, for these societies frequently started off with no initial capital beyond that provided by the first monthly subscriptions of members. The member purchasing the right to an advance would then receive the advance, and be under no liability to pay interest upon it, but would be under

liability to continue his monthly subscriptions until all members had received their advances. The society would then have no further function, and would dissolve. The membership was usually fixed.

(*b*) The "Economic" series of societies (i.e. societies having the word "Economic" included in their title). These societies functioned in a similar manner, save that the right to receive advances was determined in order of priority of membership.

(2) Societies not making advances free of interest. There are three main groups of societies, largely based upon geographical differences, namely the "Rotherhithe" series, a series of societies in and about South London, the "Swansea Liberal" series in South Wales, and the "Mutual" series in Sussex and Hants. Each member pays a weekly or monthly subscription for each share he holds, and, although membership is unlimited, the existence of a general rule that each new member joining must pay a sum equivalent to the total of subscriptions due on his share, calculated from the society's inception, provides a check on the increase in membership after the society has been in existence for a year or two. The member, when he obtains his advance, has to pay an increased sum each month on his share by way of interest. No repayment of interest on subscriptions is made during the lifetime of the society. From the records of these societies it seems that their average life is about twelve years, it being more to the advantage of new borrowers to form a fresh society than attempt to join an old one.

They usually borrow heavily from banks at their inception, to provide their members with advances as quickly as possible.

It is important to remember that individuals formed societies and commenced payment of monthly subscriptions before actually acquiring an advance from the society.

The statistics of Terminating Societies (based upon the registrar's report for 1931) are as follows :

Societies making advances free of interest :

Number of Societies	135
Number of Share Investors	19,434
Number of Borrowers	2,951
Advances on Mortgage during year	£153,779
Liabilities, etc.	
Shareholders	£952,503
Depositors	£13,073
Other Creditors	£12,775
Profit and Reserve	£118,016
Assets	
Balance due on Mortgages	£977,043
Total	£1,096,367

Ordinary Terminating Societies :

Number of Societies	47
Number of Share Investors	5,543
Number of Borrowers	2,541
Advances on Mortgage during Year	£203,880
Liabilities, etc.	
Shareholders	£427,109
Depositors	£67,108
Other Creditors	£326,437
Profit and Reserve	£82,722
Assets	
Balance due on Mortgages	£837,983
Total	£903,376

The registrar's report for 1933 does not distinguish between the two different types of society. The total figures are :

Number of Societies	164
Number of Share Investors	22,050
Number of Borrowers	4,853
Number of Depositors	442
Amount of Advances during the year	£338,193
Liabilities	
Shareholders	£1,315,703
Depositors and other Creditors	£382,745
Profit and Reserve	£166,497
Assets	
Balance due on Mortgages	£1,729,306
Other Assets	£135,639
Total	£1,864,945

This shows the shrinkage in terminating societies over the two years.

(*ii*) *Permanent Societies*

This is now by far the largest group of societies, and, apart from minor variations in rules, mainly with regard to premiums and fines, forms a fairly homogeneous section.

Their main characteristic at the present time is the division between borrowers and lenders. Although borrowers have to become members, this is a mere matter of form, and the borrower may borrow as soon as he joins, and pays no more in subscriptions than the agreed rate of interest on the amount of money he obtains plus the agreed amount of periodic repayments of capital.

The lender, on the other hand, may deposit money with the society as he would with a bank, but at a higher rate of interest, or he may take up shares, which involves simply the deposit of money on conditions which require longer notice of withdrawal and usually provide him with a slightly higher rate of interest than the ordinary depositor.

In short, permanent building societies are no more than investment trusts specialising in the provision of finance for house and land purchase. There seems no limit to the amount of money which they can take from the national income available for investment other than their own capacity for its absorption and remunerative employment.

The growth of building societies is illustrated by the comparative figures quoted from the registrar's report in the table on the opposite page.

4. PRESENT STATUTORY REGULATIONS AFFECTING BUILDING SOCIETIES

Permanent building societies are regulated by the Building Societies Acts of 1874, 1875, 1877, 1884, and 1894. The principal Act is the Act of 1874 ; the later Acts extend and amplify it.

Certain terminating building societies (founded before 1867 and not becoming incorporated under the 1874 Act) are subject in the main to an earlier series of Acts, in general on lines corresponding to the Friendly Societies Acts. Inasmuch as these terminating societies

Year	Number of Societies on Register at end of Year	Number of Members	Amount Advanced on Mortgage during Year	Balance due on Mortgages	Percentage of Total Mortgages: Mortgages over £5,000	Properties in Possession	Mortgages in Arrear	Other Mortgages
			£	£				
1914	1,506	627,240	8,761,950	61,049,942	3·3	3·2	0·5	93·0
1915	1,451	626,174	6,530,986	59,889,480	3·2	3·1	0·6	93·1
1916	1,402	620,335	4,924,842	57,099,267	3·2	2·8	0·7	93·3
1917	1,366	612,753	4,484,794	54,477,004	3·1	2·6	0·8	93·5
1918	1,336	625,013	6,970,986	53,207,803	3·1	2·3	0·7	93·9
1919	1,311	672,369	15,840,961	57,865,967	3·7	1·4	0·6	94·3
1920	1,271	747,589	25,094,961	68,811,690	3·7	0·8	0·3	95·2
1921	1,226	789,052	19,673,408	75,503,123	3·7	0·6	0·2	95·5
1922	1,184	826,032	22,707,799	83,724,928	4·2	0·4	0·2	95·2
1923	1,151	895,524	32,015,720	98,844,991	5·2	0·2	0·2	94·4
1924	1,112	1,000,988	40,584,606	119,744,926	5·4	0·2	0·1	94·3
1925	1,092	1,129,455	49,822,473	145,857,119	4·8	0·1	0·1	95·0
1926	1,064	1,257,400	52,150,941	171,220,815	4·2	0·1	0·1	95·6
1927	1,054	1,416,456	55,886,903	197,748,150	3·8	0·1	0·1	96·0
1928	1,035	1,130,066	(58,664,684) (11,189,169)	227,532,832	3·3	0·1	0·1	96·5
1929	1,026	1,265,329	74,718,748	268,141,456	3·4	0·1	0·1	96·4
1930	1,026	1,449,432	88,767,426	316,313,559	3·2	0·1	0·1	96·6
1931	1,013	1,577,905	90,253,133	360,176,859	3·1	0·1	0·1	96·7
1932	1,014	1,692,167	82,142,116	388,377,535	2·9	0·1	0·1	96·9

are a limited and closed class of societies, now nearing extinction under the old regulations, it is perhaps unnecessary to examine in detail the Acts affecting them.

The principal provisions of the Act relating to the remaining societies are as follows :

(*a*) A society upon incorporation becomes a body corporate.

(*b*) The rules of each society must be enrolled with the registrar (who is the Chief Registrar of Friendly Societies).

(*c*) The liability of members is limited to the amount actually paid or in arrear on his share.

(*d*) The borrowing power of societies is limited to two-thirds of the amount secured to the society by mortgages of its members.

(*e*) Certain requirements have to be set out in the rules of the society, of which the principal are :

(i) Regulations as to rule alteration, etc.

(ii) Appointment and remuneration of directors, auditors, and other auditors.

(iii) Provision for an annual or more frequent audit.

(*f*) Rules may be altered by a majority of three-quarters of the members present at a meeting called for that purpose.

(*g*) Officers of the society must give security.

(*h*) Surplus funds may only be invested in trustee securities.

(*i*) Societies may only acquire land for the occupation of the society.

The following additional provisions were made by the Act of 1894:

(*j*) An account in a specified form must be filed annually with the registrar. The account must total and classify the existing mortgages to the society (the classification being one of amounts due thereunder to the society) and must have an auditor's certificate attached.

(*k*) One of the auditors must be a person who publicly carries on the business of an accountant.

(*l*) On the application of ten members, the registrar may direct an inquiry into, and report on, the affairs of the society, and, if one-tenth of the membership requests, he may also call a special meeting of the society.

(*m*) The registrar has power to suspend or cancel the registration of a society and to dissolve it after investigation.

(*n*) Balloting for advances is prohibited.

(*o*) Directors and others may be punished by fine for breach of the statutory requirements.

(*p*) Officials accepting gifts, commission, etc., are liable to a fine of £50.

Statutory rules were made under the Act in 1895 covering certain matters of detail and specifying the forms to be used for the purposes of the Acts.

5. PRESENT TENDENCIES OF BUILDING SOCIETIES

As has been seen, building societies have increased enormously in the last ten years. Their total balances

due to them on mortgage have increased from £57,865,967 in 1919 to £388,377,535 in 1932. During 1930, £58,419,000, or more than the 1919 total advances, was added to the capital of building societies.

It is always difficult to disentangle cause and effect. Have building societies grown by reason of the demand for agencies for investment, or have they grown by reason of the demand for money for house purchase?

On balance it would seem that their growth is a result of the demand for money for house purchase.

The housing situation from 1919 to 1929 is sufficiently well known not to need detailed description. The period was characterised by considerable activity in the provision of what may be described as houses for the middle classes. The housing shortage after the war made it necessary for those who desired a house to live in to buy it. The purchase of houses was encouraged. The psychological aspect of house ownership was fostered. Workers in receipt of weekly and monthly salaries, who, prior to the war, would have rented a house, were encouraged to buy, were told it was the best way of saving, and while inflated rents had to be paid for houses to let, and while the market for houses continued stable, it was, from certain points of view, advisable to buy. The result was, the builders built houses to sell and only to sell, and the arts and wiles of the advertiser were employed to persuade and

enable the middle and working classes to buy on "deferred terms." This is illustrated by a rather interesting analysis of the "social status" of borrowers, contained in Sir Harold Bellman's article before referred to, which gives figures from the Abbey Road Building Society's records not otherwise available.

A COMPARISON OF SOCIAL STATUS

Description	Abbey Road Society's Borrowers	Great Britain and North Ireland [1]
Wage earners	37 per cent	76 per cent
Salaried	24 per cent	14 per cent
Independent Workers, Employers, Farmers, Professional	19 per cent	10 per cent
Miscellaneous	20 per cent	—

In short, the number of houses built in England and Wales from the end of the war is estimated to be about two million. It was recently estimated by the Ministry of Health that about one-third had been built to let and that the remainder had been built for sale.

This phase naturally required its complementary side—namely, the growth of organisations willing to advance the money for the purchase of houses, repayable by instalments of interest and principal over extended periods. Building societies consciously and unconsciously set out to meet the demand. And to do so they had to attract the money necessary to enable them to do it.

They were assisted in this by the fact that, by

[1] Estimated by Bowley and Stamp.

arrangement with the income-tax authorities, they are able to pay interest on deposit without deduction of tax. All other individuals and authorities paying interest on borrowed money are entitled—in fact, required—to deduct from the interest payments income tax at the current rates. At the high rates of tax prevailing since the war this has meant a considerable proportion of the interest due. This tax is deducted regardless of the recipient's liability for tax, and the recipient, if not liable for tax, or for all the tax deducted, has to reclaim it from the tax authorities. And that, for the small investor, is not an easy process. The result is that the building society is in a position to offer a concession not elsewhere available.

The fact that building societies have drawn into themselves a proportion of vastly greater savings than they did before the war is evidenced by the fact that their growth has been greatest among the largest societies. That is to say, the larger societies, the societies with the longest history and best-known names, the societies best able to advertise for business on the largest scale, have been able to grow faster than any of the others.

This is evidenced by the following figures from the registrar's report, the figures for the year 1930 being given, as this represents the "peak" year of many societies.

These figures also show the size of the annual turnover of societies, and of course how much their profits must depend upon its maintenance.

Name of Society (Abbreviated)	Advances during the Year — Amount £ 1930	Advances during the Year — Amount £ 1932	Proportion of Advances to Balance due at beginning of year Per cent 1930	Proportion of Advances to Balance due at beginning of year Per cent 1932	Balance due on Mortgage — Amount £ 1930	Balance due on Mortgage — Amount £ 1932	In Arrear or in Possession Per cent 1930	In Arrear or in Possession Per cent 1932
Halifax	16,893,072	16,618,118	37·7	27·8	52,902,784	64,606,429	—	—
Abbey Road	12,299,148	3,548,690	68·3	10·9	27,944,275	32,381,659	—	0·0
Woolwich Equitable	5,591,774	2,446,124	51·3	12·6	15,066,864	19,570,310	0·1	0·0
Leeds Permanent	3,775,307	3,921,294	35·5	26·0	12,788,645	16,867,610	0·1	0·0
Co-operative	3,706,167	2,423,303	43·4	17·8	11,306,607	14,571,217	—	—
National	3,423,912	4,174,645	36·6	26·3	11,791,693	18,522,631	0·1	0·0
Bradford Third Equitable	1,596,842	1,447,199	23·3	18·8	7,245,616	7,965,370	—	—
Huddersfield	1,737,034	2,027,020	20·7	21·4	8,911,828	10,110,632	0·0	0·0
Westbourne Park	3,015,288	2,857,930	45·4	29·3	8,583,046	10,998,922	0·1	0·5
Leicester Permanent	1,609,250	1,954,625	25·0	24·1	7,311,383	9,070,702	0·2	0·2
Burnley	1,586,363	1,919,339	25·0	25·7	6,901,722	8,155,242	—	0·0
Bradford Second Equitable	721,246	821,615	16·2	18·0	4,545,305	4,634,541	0·1	0·4
Temperance	1,095,702	746,219	28·8	16·2	4,289,855	4,527,661	—	—
Cheltenham	894,908	865,465	26·3	20·9	3,804,406	4,394,123	0·0	0·2
Northampton	448,728	721,002	19·0	27·3	2,383,451	2,805,363	—	0·1

We are left, therefore, with the conclusion that the growth of building societies has been occasioned by the necessity for money for housing, and not by the necessity of a new avenue for saving.

Since 1930, however, the position has undergone considerable change.

As has been seen, the period 1919–30 was one of considerable expansion. Building societies could invest remuneratively all the money they could attract. The position now is very different. Building societies have more money than they require for their legitimate, or rather for their historical, functions, and in 1932 the amount advanced fell by £8,100,000 on the amount advanced in the previous year.

There are several causes for this : (*a*) The general depression, and consequent shrinkage in the market for houses for sale.

It is generally admitted that arrears of housing for the middle class are in process of being overtaken. The day of the enormous expansion of suburban development, in the perpetual increase of houses for sale from £600 to £1,200 in price, is over. The middle class is no longer so overcrowded that it must buy to live, nor is it any longer financially able to move to a new house or new suburb at will. Salaries have been cut, "rationalisation" and amalgamations have thrown many out of work, and the builder is no longer able to sell all he can build.

Further, the market in such houses is a falling one.

The owner who bought five years ago cannot afford to sell. The fall in the price-level has at long last affected the price of the commodity he has to sell.

At the same time there has been an increase in the amount of money seeking investment in building societies. Not only has the long pressure of advertisement and propaganda affected the direction of the stream of investment, but the general fall in Stock Exchange values, the distrust of new flotations taught by a long series of fraudulent and reckless flotations of new companies, have encouraged the *rentier* class to look at the building society as the one place where £1 paid in five years ago is still worth £1. He has lost hope of being able to convert it into 30*s.* by his own acumen. Building societies are therefore faced with loss instead of gain.

This loss arises in two ways. First, as we have seen, they have depended for their profit on their ability to borrow at 5 per cent and lend at 6 per cent. Now they can borrow at 4 per cent, but outside the field of mortgages they can only invest at 3 per cent. And it must be remembered that, discourage fresh deposits as they may, colossal sums of principal are repaid each month by their mortgagors, all of which must be reinvested.

Further, they have lent money on a rising market and are faced with a sale on a falling one.

Building societies have lent up to 75 per cent of valuation. If a house that cost £1,000 in 1928 is now worth less than £750, the building society will lose,

for what small percentage of principal has been paid is more than offset by the cost of a sale. Furthermore, the house has got to be sold, and, if it stands empty for twelve months, twelve months' interest has gone. And if the owner-occupier has lost his job and has gone, leaving no address, the value of the right to sue for the balance of loss is not appreciable. We will consider other aspects of this situation in the next section.

At the present moment, therefore, building societies are faced with a dwindling market for their wares, with a pressure to maintain the flow of investment, and their tendency is to seek fresh fields in which to operate, fresh methods of maintaining their profit.

6. ABUSES OF THE PRESENT SYSTEM

Before passing on to consider the present activities of building societies under the changed economic pressure to which they are now subjected, we may usefully look at some of the abuses which have grown up within, and in consequence of the recent change in conditions.

A. *In General*

We have seen that the ten years from 1919 to 1929 resulted in the large-scale purchase of houses by a class that had not previously purchased property of any kind. At first it was the shortage of houses that compelled the individual to buy. Latterly it is the result of the builders' reluctance to build a house to let.

That reluctance is easily understood. The Victorian builder built and let. He acted as his own rent-collector, and gradually reduced his mortgages and acquired capital by the surplus he saved from his rents. In short, he lived a hard and frugal life, and his income was never free, while he was at the mercy of a private mortgagee who might call in the borrowed money at any time on three months' notice. He might die a rich man, but he had never enjoyed a big available income.

The post-war builder preferred to avoid that struggle if he could, and if he could sell the house he had built, with the aid of a convenient building society mortgage, he succeeded. He could "cash in" on his profit at once. True, he might put some of it back into the business, but he was never subjected to the grinding uncertainty of a dead weight of an indebtedness he could never repay at any one time. The result was that he preferred to sell, and the building society made it possible for him to do so; in fact, expanded largely by reason of the fact that he did so.

We must also consider whether it was a good thing that salaried workers and the artisan class had to buy their houses and not rent them.

The advantages have been so frequently urged by the building society publicity experts, from their chairmen downwards, that they need not be repeated here. Pride of ownership, assisted saving, "buy your house with the rent"—they are all too familiar.

What are the disadvantages? They may be summarised shortly as follows:

(*a*) The worker takes on a fixed weekly liability which will extend over a period of fifteen to twenty years. During that time he is living under a system which gives him not the slightest guarantee that he will be earning enough—or indeed anything—to pay this definite commitment. This means that loss of employment during the first five years of the contract will ensure the loss of all that has been saved, and probably the complete break-up of the home, as well as a burden of debt that may be a millstone round his neck for years.

(*b*) It passes on the risk of fluctuation in capital value to shoulders not strong enough to bear it. It cannot be a good thing that the fluctuations in value of houses in a district should be borne by a weekly wage-earner.

(*c*) The financial burden is fixed in terms of cash, and a fluctuation in price-level may increase the real burden of the building society payments by as much as fifty per cent.

(*d*) It results in immobility of labour. The shortage of living accommodation and the Rent Restrictions Acts have had the same effect, but the effect of house ownership in this direction cannot be overlooked. On a falling market, the worker cannot afford to sell his house and move.

(*e*) As the burden of the payments increases with the fall in prices, the owner is forced to seek other methods of maintaining his income, and lodgers, overcrowding, the division of a house designed to

hold one family into two non-self-contained flats, results.

(*f*) The house-owner has not the capital or income available to maintain the house in good structural order. The house, probably none too well built at first, deteriorates, and emphasises the evils set out above by falling in market price in consequence.

(*g*) Is the creation of the small capitalist a good thing in itself? The orthodox point of view is well illustrated by a quotation from Sir Harold Bellman's article in the *Economic Journal*. Speaking of house-ownership, he says: "It increases personal self-respect; and it encourages civic pride and adds a wholesome stability to the political institutions of the State by giving the people 'a stake in the country.'"

Looking at some of the suburban areas developed by building society finance, the "stake in the country" seems most to resemble the stake that pinions the chained dog to the immediate vicinity of his kennel.

B. *In Particular*

Certain undesirable practices have grown up with the development of union between building societies and the speculative builder.

It is clear that in so many cases the determining factor in selling a new house has become, not the quality of the house, but the terms on which it can be bought. That in itself must be a dangerous test to apply, and it has the further effect of driving the smaller speculative builders completely under the domination of the building society. Unless he can

offer a low deposit and easy weekly repayments, the builder is quite unable to sell.

Building societies have not been slow to take advantage of the power this state of affairs gives them. Let us suppose that a builder has acquired land on which he proposes to erect 200 houses for immediate sale at £500 a house. He must first arrange with a building society that they will finance the sale of each house. He is the weaker power, and the building society can and does dictate terms.

The purchaser of an individual house has to find £500, together with the legal expenses, which may be estimated at, say, £15. Usually he is not in a position to pay more than between £25 and £50 cash, and the balance therefore has to be borrowed from one source or another. We may say, for our present purpose, that a balance of £475 has to be found.

The usual practice of building societies is that they will not lend more than 70 per cent of the value of the house, which may be assumed to be the selling-price. In this case they would normally advance £350 on the house, which leaves a further £125 to be raised before the house can be sold.

It is possible for the builder to allow this £125 to remain on mortgage, the mortgage ranking after the building society's first charge of £350, but this method is not general, first because building societies do not encourage arrangements which result in others having a second charge upon the property; they prefer to

have complete control themselves. Secondly, this method is not attractive to a purchaser, because he does not like being subject to liability to make repayments to two separate concerns, nor does he like being under liability to a builder as to whose financial stability he has no information whatsoever.

Building societies have devised a scheme to meet these difficulties. They have made a practice of advancing the balance of the purchase money, after deduction only of the small deposit paid by the purchaser, on condition that the builder deposits with them as collateral security a sum equal to the difference between their normal advance and the advance which they actually make. In the concrete case set out above the building society would require the builder to deposit with them a sum in the neighbourhood of £125 in respect of each house. That is to say, the builder would be compelled to deposit the whole of his profit on the transaction with the building society, and there it would remain until the purchaser had by his instalments reduced the principal outstanding under the mortgage to 70 per cent of the price he paid for the house.

Building societies have gone further than this. They have stipulated that the moneys so deposited with them by the builder should be collateral security, not only for the mortgage on the individual house in connection with the sale of which the money was paid in, but in respect also of every other house sold by that

builder and financed through that building society. This means that the whole of the profit of the builder, and, indeed, some of his working capital, is locked up in the coffers of the building society. On this—such is the irony of the Income Tax Acts, the builder pays income tax in cash.

What is the result of this system? A purchaser defaults, and the house has to be sold. Probably the house has been occupied for some little time, and requires a certain amount of money spent upon it for decorations and minor repairs. The building society is only concerned to see that its advance of 70 per cent is secured—not even that, while the pool is solvent—and, as sole mortgagee, sells the house for what it will fetch near that figure. The result is that, if houses are in fair demand in the neighbourhood, the house is sold to a speculator who spends a small sum of money on doing the house up and resells, with the aid of another building society advance, at a profit. If the house is not sold in that way, it remains empty until it is sold at what it will fetch. The building society will not let; that would involve taking possession of the house, and, inasmuch as building societies in their annual return are compelled to disclose the number of houses of which they have taken possession, they prefer to wait for a sale, for they do not wish to alarm their depositors and shareholders by letting it appear that their security may be in jeopardy.

The builder whose money is involved is powerless.

The only way in which he can control the sale of the house by the building society is by buying it himself and obtaining a fresh advance, but, as his collateral deposit still remains in the hands of the building society, he has not capital enough to do that frequently. He can only look on and see his profit and working capital disposed of by the building society as they think best. There are many builders to-day who on paper are wealthy men, but who cannot find the weekly wage-bill in cash.

7. EXTENSION OF BUILDING SOCIETIES' ACTIVITIES

We have seen that the vital need facing the directors of building societies is the discovery of new and profitable sources of investment for their increasing holdings of cash. The public and political activities of various directors of building societies during the last few months give some indication of that pressure.

It is clear that building societies can make no contribution to the problem of slum clearance. Without diverging into the question of housing it is impossible to consider that aspect of the problem, but if there is one thing that is clear, it is that private enterprise cannot provide housing for the lowest paid wage-earners. It cannot because it cannot do so at a profit. It therefore washes its hands of that scandal—and raises its individual voice to protest against any Government or municipal expenditure on any activity,

including that of slum clearance and rehousing, during this time of "national crisis." If private enterprise will not build, it does not need the building societies' money.

It follows, therefore, that building societies have no place in that problem. They are inseparably linked with private ownership. Local authorities do not need their financial help. Their difficulty is to obtain permission to borrow at all. If they can borrow, their credit is good enough to enable them to borrow on terms almost as good as those available for the Government. An authority which can successfully float a $3\frac{1}{2}$ per cent loan in the City of London need not pay a building society $5\frac{1}{2}$ per cent.

At the present moment building societies are openly pressing two lines of attack.

The first is the stimulation of the private owner to redecorate, repair, and improve his property, with borrowed money. In so far as the private owner is in a position to pay any increase in his building society repayments, that seems a desirable activity, and one which will meet with success.

The other is evidenced by the last Government Housing Act. The Housing Act, 1925, gives power to local authorities to guarantee repayments of advances made by building societies to their members to enable them to build or acquire houses intended to be let to "persons of the working classes." Section 2 of the new Act gives the Minister power to underwrite the

liability of the local authority up to one-half of any loss sustained by them under its guarantee, provided the guarantee of the local authority extends only to that portion of the advance in excess of what the building societies would normally advance with guarantee.

It is obvious, to say the least, that the Government's insistence that the housing problem can best be solved by private enterprise is entirely to the building societies' advantage. It is so much more desirable for them that the individual should be forced to buy and borrow from them at 5½ per cent the money he requires to do so and not be able to rent a council house. It is also desirable that builders should be encouraged to build houses to rent. For there again the builder will need a mortgage to cover his capital cost of building.

The present trend of building societies' activity may be illustrated by an article by Sir Harold Bellman, one of a series of articles on a proposed National Housing Corporation, in the *New Statesman.* This article appeared in the issue of February 18, 1933. Sir Harold says, apropos of the finances of such a corporation, "A number of institutional investors would . . . be prepared to lend it support. While building societies' opinion has not been canvassed, I see no reason why societies should not be included among these institutional investors. One of two things, however, would happen : either investments with the

board would have to rank as trustee investments, or the Building Societies Acts would have to be amended to give societies express authority to advance to the board. It is apparent that while in some respects the societies might be co-operating with the board, in others they might be competitors. Clearly an advance definition of functions and apportionment of territory is indicated, nor should this prove very difficult. For instance, as long as the board is dealing with the slum problem it would not be competing directly with building societies. . . . Again, the financing of *existing* property might be left to building societies and other agencies . . . possibly the board might not have to provide finance for new building apart from slums, except where it was not forthcoming in adequate volume or on acceptable terms from existing agencies. These, however, are details which could be settled only after long and careful inquiry."

In short we can say, therefore :

(*a*) Building societies are finding it increasingly difficult to invest their money.

(*b*) Their scale has grown so much that the total of the money they have to invest is very considerable.

(*c*) A building society can only lend to a private owner who wishes, and can afford, to buy his house, or to a builder who is so certain that profit will result that he is prepared to build houses to let.

(*d*) Every municipal house let and every house-purchase municipally financed is a direct loss of a customer to a building society.

(*e*) There is no market for building society investment by reason of municipal house-building or house finance.

It is not hard to judge from these facts in what direction the influence of building societies, and of their 300 millions of money, is exerted.

8. PRESENT ALTERNATIVE METHODS OF THE PRIVATE FINANCE OF HOUSE-BUILDING AND PURCHASE

There are three alternative methods at present open to the individual who wishes to acquire or build a house and who has not the necessary capital to enable him to do it.

A. By Private Mortgage

This simply involves finding an individual willing to advance money on the security of a mortgage of the house. Funds available for investment in this way are usually controlled by solicitors or surveyors. Its disadvantages are the expense of its procuration and the fact that it may be called in at any time on three months' notice.

B. From Insurance Companies

Certain insurance companies have for many years specialised in the advancing of money for the purchase or construction of houses. Almost invariably the companies are life insurance companies, and they stipulate that the borrower should assure his life for a sum

equal to the amount of the advance. In many ways these mortgages have advantages over building society mortgages, inasmuch as no capital is included in the monthly payments, and on the death of the borrower the capital sum payable under the policy is at least sufficient to discharge the mortgage outright. The disadvantage is the addition of the annual premium on the policy to the total amount which has to be paid each year, and, what is more important, the fact that it has to be paid in one sum. In fact, the total payable each year is approximately the same as would be paid under a building society mortgage of the same amount, and if insurance companies would accept interest and premium by monthly instalments they would, with some propaganda, successfully compete with building societies. Such mortgages provide a valuable outlet for secure investment for insurance companies looking for long-term investments, as well as a useful method of introducing new business for their life assurance departments.

C. *From Local Authorities*

Local authorities have full powers of satisfying all needs of house-purchase finance if they choose so to do.

Under the Small Dwellings Acquisition Act of 1899 as amended by subsequent Housing Acts, local authorities have power to advance to a resident or prospective resident of any house within their area, for the purpose of the acquisition of his house, 90 per

cent of the market value of the house. Repayment of the advance may be spread over thirty years; payments on account may be made each quarter day on one month's notice (in the case of a building society advance, credit for excess repayments is only given at the end of the year in which they are made). The condition of residence means that the owner must reside in the house for three years after the date of the advance, but the authority may dispense with the condition, and in any event the owner may let the house furnished for four months in every twelve, or during the time the conditions of his employment require his absence from the district.

The Act does not need adopting by the local authority. Primarily, the local authority is a county council or county borough, but urban and rural district authorities may resolve to take over the powers of the Act and become the authority. Councils must operate the Act at a cost to themselves of not more than a penny in the pound of the local rate; inasmuch as they can borrow more cheaply than they need lend, the undertaking should at least be self-supporting. The money for the advances is obtained from the Public Works Loan Commissioners.

Practically the only difference between such an undertaking and a building society is the fact that councils do not need to spend money on either advertising, pleasantly furnished offices, or directors' fees. The difference is not one which should operate

to the disadvantage of the finance of the scheme.

The advantages of such a method of purchase to the individual are :

(*a*) He is usually required to pay a lower rate of interest to the local authority, i.e. $4\frac{1}{2}$ per cent as against 5 per cent.

(*b*) The local authorities' survey is completely independent from that of the builder, and for that reason may be a more accurate estimate of the real value of the house erected.

The powers under these Acts have been used in varying degrees throughout the country. Some local authorities have, through inertia or ignorance, made no attempt to make the facilities available for the inhabitants of their areas ; some have a dislike of increasing their nominal indebtedness by the borrowing of the necessary funds from the Public Works Loan Commissioners, although they are able to do so on terms which may yield them a profit rate of interest of $\frac{1}{2}$ per cent to 1 per cent ; others take the view that it is unnecessary for local authorities to supply a need which seems to be adequately met by private enterprise.

Mention should also be made of various other organisations which assist their own members or employees with finance. Prominent examples are the railway companies through their provident societies, some of the bigger insurance companies and banks (the Bank of England will advance money to its

employees for that purpose at 4 per cent), most of the provident and friendly societies, and some of the co-operative societies, although most of the latter work through the Co-operative Building Society.

9. BUILDING SOCIETIES UNDER SOCIALISM

As we have seen, building societies are following two lines of development. The first is their original function—that of voluntary associations of individuals desirous of raising finance for the acquisition by themselves of a house in which to live. It is the function most clearly apparent in the old terminating type of society. The other is the transformation of the larger permanent societies into large investment corporations speculating primarily in the finance connected with the acquisition of real property of all kinds.

Before proceeding further, it is necessary to emphasise that building societies as such have no function after the abolition of private property in land. They are a function of private ownership and private enterprise, and once it is accepted that it is the duty of the community to ensure that its members are adequately and properly housed, the need for the existence of organisations primarily concerned to assist the individual to that end ceases. It follows, therefore, that building societies should only continue to exist as such during the transitional period.

Further, the dual purpose of the building societies must be borne in mind. The building society does in

fact first provide a channel for investment for the small capitalist, and secondly it subsequently lends out the money so entrusted to it.

Dealing first with the provision of finance for the acquisition of houses, our proposals are as follows :

A. The finance of new housing can, for the reasons set out above, be more satisfactorily dealt with by local authorities than by the existing large-scale building societies, and the machinery for such finance by local authorities can and must be strengthened and extended. At present money can be lent by any local authority, from a rural district council upwards. To prevent overlapping of machinery, a larger unit than the R.D.C. might be considered as the proper channel, such as regional councils in areas not covered by county boroughs and urban district councils, but further consideration of that point ought properly to fall within the ambit of a revision of the machinery of local government.

B. Terminating building societies might be restored and encouraged for the provision of finance for the purchase of existing property, subject to the imposition of a proper audit and survey by the district auditor and local surveyor's departments. The district auditor ought to make an annual audit and report, and also a number of surprise check audits in each year. It might also be desirable to bring within the scope of building societies' regulations all other private organisations

making advances for house acquisition to their members or employees.

Dealing secondly with the function of building societies as investment corporations, our proposals are as follows :

A. As from a fixed date all permanent building societies should be consolidated and, so soon as satisfactory provisions for the financing of house-purchase by the methods referred to above are complete, their function as lenders of money to private individuals terminated.

B. The result of this would be that the amalgamated corporation would find itself with a large collection of assets, mortgages, and cash, repayable by instalments, and with a corresponding collection of liabilities. It would also be the inheritor of a large organisation for the collection of small savings. A great deal could be saved by the elimination of competition between societies.

C. It would naturally follow that the machinery of the corporation would have to be divided into two parts for two separate purposes :

(1) The gradual conversion of the existing assets into cash.

(2) The reinvestment of that cash and the investment of any further sums of cash entrusted to it.

D. The general supervision of the investment of such cash would fall within the duties of the National Investment Board, but to preserve continuity, and for

psychological reasons, it would be desirable that the corporation should continue to be associated with the finance of housing.

E. The funds of the corporation might be employed :

1. In the finance of slum clearance by local authorities in small areas where the local authorities are not of a size sufficient to make public borrowing an easy arrangement.

2. In the finance of new housing and building schemes in similar areas.

3. Thereafter in the loan of money to local authorities for advance to private individuals for the acquisition of houses.

It is apparent that the future activities of such a corporation would be indissolubly linked with any national housing policy. The creation of a National Housing Corporation is already a project which is under discussion, and there is no place here for a consideration of the scope and function of such a corporation, or of the lines on which the provision of housing ought to proceed. But it is obvious that any plan for national housing will need finance, and it seems clear that the building societies provide a channel for investment now popularly associated with housing, managed by officials with considerable experience of housing conditions, and having at its disposal a large body of funds available for immediate use. In these circumstances the adaptation of building societies to the finance of national housing might

prove an easy and convenient method of approach to the financial side of the housing. It would, however, probably be necessary to limit the immediate withdrawal by individuals of the whole of their deposits or credits with the society of which they had been a member.

The utilisation of the building society machinery for housing finance might be extended further. Primarily it would depend upon the scheme adopted for national housing development, but in general it is clear that the raising of loans by the smaller local authorities by means of a public issue of stock is an unnecessary and wasteful operation. All local authorities desire at times to raise money for local building, whether for housing or for offices, and the cost of raising those loans from private sources is in the aggregate considerable, and is money thrown away. If authorities raising money for those purposes, in quantities insufficient to render it economic to make a public issue, were empowered to borrow from the corporation as an alternative to other sources, a considerable saving would result. It must, however, again be emphasised that the use of building societies as an investment medium must form a part of a national plan, and must be subordinate to that national plan.

In conclusion, we have seen that the growth of building societies is a recent development in the financial structure of the country that does not appear to have received sufficient attention; that under

present conditions such an extension of their activities has brought in its train evil consequences both from a general and a particular point of view; that, inasmuch as the economic power of the banks must be brought under the control of the community and consciously directed towards ends to the benefit of the community, so must the economic power of the building societies similarly be controlled and directed; and that within the framework of a national plan the machinery of the building societies' organisation provides an admirable instrument for the collection of a considerable portion of the national savings. It is the boast of England that her institutions are flexible enough to withstand the transition from one purpose to another. Building societies are yet an additional example of how an historic organisation by intelligent direction can be made to serve only the ends of the community.

FOREIGN INVESTMENT

ERNEST DAVIES

FOREIGN INVESTMENT

I

FOREIGN INVESTMENT has probably played a more important role in the economic structure of Great Britain than in that of any other country. Through the annual export of capital, and reinvestment of balances accumulated abroad, there has been built up a fund of a nominal value of between £3,000 million and £4,000 million, from which an income of between £100 million and £200 million accrues annually.

This has enabled this country to enjoy a higher standard of living than would otherwise have been possible, both during times of prosperity, when an increase in investment abroad stimulates exports, and during times of depression, when income from abroad, by financing imports, has acted as a cushion against the worst effects of the trade cycle. The maintenance of this standard of living through the protection of our foreign markets and investments has been one of the main guiding principles of British foreign policy. The protection of the routes of Empire, and the development of spheres of influence in all parts of the globe, are but two instances of how our foreign policy has been inspired by this necessity of protecting at all costs those foreign interests without which this country

would be unable to support its present population at any reasonable economic level. This chapter, dealing as it does with the nature, extent, and technique of foreign investment, cannot deal with these broader issues of imperial policy which will eventually determine the nature and extent of future investment abroad. It has been necessary to assume the continued existence of foreign investment under Socialism—although this would be done by the State rather than by the individual—in order to maintain, at least during the transition to Socialism, our present standard of living.

The standard of living is affected both by the making of the foreign investment itself and by the income derived therefrom. Investment abroad is in many respects equivalent to granting long-term credits to industry for the financing of exports. While only of recent years conditions as to the spending of the credit raised have been attached to the granting of the loan, normally new money raised is used in the country of origin. The only alternative is the shipment of gold. The actual expenditure may be in the direct purchase of manufactured goods, machinery, etc., or it may be indirectly, through the increased demand for other imports on the part of the community which has received the loan. In this way the export trade of this country has been largely built up and maintained through foreign investment. For example, a new company raises money in London to build a railway

abroad. The money subscribed by English investors is used to buy steel rails, locomotives, wagons, and other goods required for the construction of the line. Part will be used for disbursements abroad, but gold will not be shipped for that purpose, as it is assumed that in the long run the increased purchasing power created there will help to increase the demand for British services and goods. That is the effect of foreign investment in its simplest form. In actual practice, the balancing of the expenditure at home and the remittances overseas may pass through a diversity of hands in a number of countries ; but in brief it can be said that the lending of money abroad sets in motion a series of operations, the ultimate result of which is to finance industrial activity in, and exports from, the country granting that credit. This in its turn creates employment, and increases purchasing power, which are important factors in the standard of living.

That is only the beginning of the transaction. The railway having been built, an attempt will be made to operate it at a sufficient profit to enable a return to be received on the capital subscribed by the English investors. If successful—and the enterprise would not have been undertaken unless there were fair chance of success—an annual remittance of profit will have to be made. The income which arises can be disposed of in three ways : (1) Reinvestment abroad, (2) Importation of goods, (3) Shipment of gold. As the debtor country is unlikely to be in a position to ship gold,

and in any case would only do so as a last resort against default, it is through a combination of the first two that the payment has to be made. Goods have to be exported by the debtor and imported by the creditor country. As these goods do not have to be met by an equivalent amount of exports on the part of the creditor country, an adverse balance of trade is inevitable for creditor countries if debtor countries meet their obligations. This adverse trade balance is advantageous, making possible, as it does, a higher standard of living than would be attainable if the country were entirely dependent on its exports for its imports. This higher standard translated into actual practice in a planned economy could mean that a greater amount of leisure could be enjoyed by all the community; the imports received as tribute removing, theoretically, the necessity for exports. Followed to its logical conclusion, a steady increase in this country's foreign investment could go on until all imports were received free and hours of work very much reduced ! From the debtor country's point of view this position would be insupportable, and as a consequence in practice, for equilibrium to be arrived at, that portion of the income or repayment of capital which arises, and which cannot be remitted by exports on the part of the debtor, is re-lent through further investment. When this, as will be seen later, is not done voluntarily, the exchange collapses, and it has to be done compulsorily, through an embargo on

foreign exchange remittances and through default on interest payments in foreign currency. It is on the investment abroad of the surplus of creditor countries that the true operation of the gold standard depends; if there is to be a return to gold, foreign investment will have to be resumed. As long as this country depends on imports for the necessaries of life, foreign investment must form an important factor in its economic structure, even during a transition to Socialism.

If foreign investment must continue even when a Socialist Government is in office, it is necessary to turn it to the greatest possible advantage. This is dealt with at greater length later. All that is necessary to say here is that one of the great assets of foreign investment is the power it gives the creditor in his relations with the rest of the world. It provides him with a weapon which can be effectively used in bargaining for trade advantages, alterations in tariffs, etc. In addition, in times of emergencies it enables the mobilisation of some foreign investments which may provide the necessary foreign exchange to purchase necessities which otherwise might not be possible. The large holdings of British companies in American securities were used in this way during the war to pay for war supplies, the British holders being given ample sterling compensation. This could prove of great value in the event of obstacles being put in the way of trade between Socialist Britain and the capitalist world.

2

So far I have dealt only with the credit side of foreign investment, but there are certain conditions under which it can be disadvantageous. In the first place, the argument that foreign investment is followed by an increase in exports presupposes that in the country making the loan costs are sufficiently low to make the purchase of goods there of benefit to the debtor. The country making the loan must be able to provide the goods at low or competitive prices or the money might be withdrawn to purchase goods in other markets. If prices in a creditor country rise above the world level, continued foreign investment might not be compensated with increased exports and an adverse balance of payments might result, with the resultant corrective provided by a fall in the exchange and loss of gold. An advantage of the free trade of pre-war days was that prices of British goods were not artificially raised through tariffs, and no handicap was put in the way of exports resulting from foreign investment, nor were our markets closed to the imports from our debtors.

The main argument used against the lending of money abroad is that the country's available savings are diverted from home investment. Industry at home is starved of capital while foreign industry prospers. Witnesses concerned with foreign investment questioned before the MacMillan Commission denied that

such was the case. As has been shown in other sections, the proportion of new savings which goes into industry by way of the new issue market is comparatively small, and there is no evidence that home industry has been unable to raise capital when sufficiently attractive terms can be offered. Of recent years, industries where it has been difficult to raise capital are, generally speaking, those operating least profitably, and particularly the export trades, such as iron, steel, cotton, and shipbuilding, all of which suffer most from an inward or closed policy and would normally benefit from investment abroad. If home industry is handicapped, it is due more to the poorer organisation of the raising of capital for home markets than to the greater attractiveness of overseas issues. On the other hand, an embargo on foreign investment, because it isolates the home market, does lead to cheaper money, sends up prices, first of fixed interest and then of all investment stocks, thereby making it easier for industry to raise fresh capital. That happened during 1933. Institutions had to find an outlet for the money available for investment, and all foreign markets, through exchange uncertainties, being unattractive, the banks were glutted with money, and prices of investments rose steeply—and possibly higher than current economic conditions justified. There followed new issues raising money for industry on cheap terms. It must, therefore, be admitted that an absence of foreign investment may cheapen the price of new capital for

home industry. But, as only industry concerned with home markets would benefit, it would be at the expense of the exporting industries. During the transition to Socialism some form of managed currency or controlled inflation is likely, and it is reasonable to assume that ample credit would in any case be created for home purposes, and the amount available for abroad would be carefully regulated on the lines discussed later.

There are occasions where the offer of more attractive terms abroad might take money from the country from which no direct benefit, or possibly no benefit at all, accrues. During a period of low interest rates at home, and abnormally high rates abroad, this can easily happen. For instance, little, if any, real benefit can have accrued to the country as a whole from the lending of money to German municipalities in the nineteen-twenties at from 7 to 10 per cent, when only 5 per cent or less was obtainable at home. It aided in the reconstruction of Germany (and indirectly helped to make German industry a more powerful competitor) and provided her with funds to meet reparation payments, but it had no beneficial effect on British trade. In fact, such investment proved particularly harmful, as it was partly made with foreign balances deposited in London, and when they were withdrawn in 1931 the German investments could not be liquidated. Lending abroad with borrowed money purely to obtain a higher rate of

interest would certainly cease under Socialism, if for no other reason than that its only benefit is encashed by the *rentier* class.

It is also necessary to consider the point of view of the debtor country. While the development of new and backward countries is considered progress, the greed of the entrepreneur in his search for profit leads to the exploitation of one country by another. This has been the characteristic development of various parts of the British Empire, and is true of Imperialism, the ethics of which need not now be debated. On the other hand, the over-willingness to lend abroad may lead to too rapid development, and the creation of a standard of living which could not be maintained if borrowing ceased. This happened to a large extent in Australia, where continued borrowing in the London market enabled the Australian artisan to enjoy at one time a higher standard of living than members of the same class in the country from which loans were obtained. When the slump came, the cessation of lending, combined with the fall in prices, necessitated drastic retrenchment. Yet another evil, and undoubtedly the worst of the three, is the creation of absentee ownership. The foreign ownership of railways, public utilities, and the like means the taxation of a community for the profit of the foreigner, which must sooner or later create conflict. As is discussed later, this can be overcome through direct inter-government borrowing.

3

In pre-war days British investment abroad grew on *laissez-faire* lines. There was neither control nor discrimination in its direction, neither geographical nor functional, the sole guiding force being profit. In the main, money flowed to those backward countries which were ripe for development, whose natural resources were sufficiently large and easy of development eventually to make their export possible for the payment of interest and redemption of capital. The form investment took in and outside of the British Empire differed. In the latter, apart from some notable exceptions, British capital was used more for capital development than for the production of consumptive goods. South America, for instance, was one of the main outlets for British capital, and there the development of the railways and public utilities—including gas, electricity, tramway, and telephone undertakings—was undertaken by English companies, this country having not only the resources, but also the renowned skill of its engineers, to call upon. The natural resources of such countries did not call for British capital for their development, although it was the exporting of the primary products in which these countries were rich that made their development with foreign capital possible.

The British Empire, colonised with British emigrants, was dependent on British capital for its entire

development, both as to primary products and capital goods. After the initial stages had been passed and Dominion status achieved, capital was obtained mainly in the form of direct borrowing by the Dominion Governments in London. Capital for internal development was subscribed by the colonials themselves, or through English companies carrying on business in the Dominions either directly or indirectly through subsidiaries. The reinvestment of company reserves and the raising of fresh capital at home for general purposes provided capital both to cultivate the Empire markets and to develop the colonies themselves without the investor being directly appealed to, or being aware that his capital was being used in this way.

Capital which was raised on the London market, apart from direct Government borrowing, built the gigantic railway system of Canada in which £213 million had been invested up to the end of 1930, developed the South African gold-mines (£50 million), the Indian railways (£90 million), and the rubber plantations of Malaya (£92 million). More than half of the money invested through London in the British Empire by the end of 1930 had been borrowed directly by Governments and municipalities, and not by companies. Of the amount raised for foreign countries, on the other hand, less than one-quarter was lent to Governments. The following table, calculated from Sir Robert Kindersley's figures covering 85 per cent

of British foreign investments in 1931, shows these percentages in greater detail[1]:

	British Empire (£000,000's)	Per cent of Total in British Empire	Foreign (£000,000's)	Per cent of Total in Foreign Territories
Government and Municipal Bonds	1,087	54·7	353	29·4
Railways	354	17·8	434	36·2
Public Utilities	63	3·2	109	9·1
Mines	92	4·6	26	2·2
Miscellaneous	391	19·7	277	23·1
Total	1,987	100	1,199	100

Percentage of total in British Empire : 62·3.

These are post-war figures, but as the bulk of this country's investments were made before 1914 they serve to show the difference between the nature of investment within and outside the Empire. The difference between pre-war and post-war foreign investment is dealt with later.

There have been two indirect influences on the direction of foreign investment : political considerations, and the unofficial influence of the Bank of England. Political influence has taken the form of direct investment by the Government, as in the case of the Suez Canal and the Anglo-Persian Oilfields, in order to protect in the one case the British sea routes, and in the other the provision of oil for the British navy. It has also been exercised in a more indirect

[1] Sir Robert Kindersley's figures referred to in this section are taken from the *Economic Journal*, September 1931 and 1934, June 1932 and 1933.

way where it is desired to develop spheres of influence, assist trade, or where our foreign policy would be served thereby.

Before the MacMillan Commission, Sir Ernest Harvey admitted that the approval or opinion expressed by the Bank of England was far more decisive in the case of foreign than domestic loans. He had to admit that it was a matter of moral suasion, although "it was quite the exception for the wishes of the Bank of England not to be observed." The Bank of England's influence, while it may at times have been effective in preventing the issue of foreign loans on the London market, was impotent to prevent foreign investment in other ways through the purchase of securities abroad or through placings of foreign investments by foreign houses. Apart from the normal movement of the exchange value of sterling influenced by changes in bank rate, these were the only controls over foreign investment in pre-war days.

In post-war days there has been a great change in foreign investment in both amount, direction, and form. The total available each year has substantially declined owing to the increase in the adverse balance of trade. Sir Robert Kindersley estimates that at 1927 values there was available for foreign investment in 1913, £263,400,000, whereas in 1927 the amount was £133,700,000. The result has been a reversal of the ratio between home and foreign issues floated on the London market. Interesting figures on this point were

given to the MacMillan Commission by Sir Otto Niemeyer.[1] He estimated the average 1907–11 ratio of new capital issues to be 21 per cent home loans and 79 per cent foreign. His figures are as follows :

	Home Per cent	Overseas Per cent
1907–11 (average)	21	79
1912	21	79
1913	24	76
1914	21	79
1922	75	25

If the figures of the Midland Bank be taken, and issues made solely for conversion purposes excluded, the figures for later years, which are not comparable on a strict basis with Sir Otto Niemeyer's estimates, are as follows :

	Home Per cent	Overseas Per cent
1927	55·9	44·1
1928	60·3	39·7
1929	62·6	37·4
1930	53·8	46·2
1931	51·7	48·3

Whereas before the war nearly four times as much capital was raised from the new issue market for abroad as for home investment, in 1922 three times more was raised for investment at home than for abroad. This difference has tended to become less marked, and in 1929, the last normal year, the amount raised for home purposes was only 67.4 per cent greater than the amount raised for abroad. In 1922 the amount raised for home purposes was 200 per cent greater. In 1931 the amounts were nearly equal,

[1] Evidence before MacMillan Commission, vol ii., p. 105.

but exceptional conditions ruled for investment abroad during that year, and have continued since. One reason for this decline in foreign investment can best be appreciated from the following extract from a speech made by the chairman of the Buenos Aires Western Railway at the 1933 annual meeting of shareholders. "The success or failure of our railway," he said, "depended in past times mainly on the efforts of those whom you employed to administer it. These to-day are not enough, and I fear will never again be enough. If, for instance, we do not receive the value in our own currency of the pesos we earn, all our efforts on your behalf are futile. The destiny of our enterprise is becoming enveloped in international agreements, and we are becoming a factor in an international equation rather than an isolated private enterprise left to our own resources."

The following estimate of the net amounts invested overseas through new issues in London since 1927 shows the decline that has taken place. The figure is made up of the estimated amount of British subscriptions to new overseas issues, less the amounts repaid during the year on loans outstanding. The 1913 figure is adjusted to 1929 index number of wholesale prices.

1913	£243,000,000	1929	£47,000,000
1927	134,000,000	1930	59,000,000
1928	108,000,000	1931	14,000,000

Control both by the Government and the Bank of England has increased. Since the abandonment of the

gold standard in September 1931, there has been a complete Government embargo on the flotation of new issues for abroad, exceptions only being made with Treasury consent. An attempt has also been made to control the placing of foreign issues in London, with the result that in 1932 £11,000,000 and in 1933 £5,000,000 more of invested capital was repaid than was lent abroad. As soon as exchange restriction was removed nothing prevented individuals or institutions from buying foreign securities abroad.

From 1926, when England returned to the gold standard, until September 1931, foreign investment proceeded with little interference. The direction was different when compared with pre-war. Little money was raised for new developments abroad or for establishing industries overseas. Existing companies, such as Argentine railways, had to raise money for normal development and for extensions, but, in the main, post-war foreign investment has taken the form of loans to foreign Governments and Dominions. After the early post-war period had brought about inflation and chaotic financial conditions, foreign credit was essential to restore some sort of financial order to Central Europe and the Near East. Loans were needed both for reconstruction and for stabilisation of currencies. As at this time the direct flotation of loans by European Governments in the London market was impossible owing to lack of confidence, the help of the League was invoked in order to restore the financial

stability of the States concerned, and thus to enable them to function normally in relation to world economy. In all cases the conditions of the loans, their amount and the purposes to which they should be applied, were determined by the Financial Committee of the League of Nations and approved by the Council; and it was this examination and approval which inspired investors with confidence and made the raising of the necessary credits possible. In this way £44,273,660 nominal was raised in sterling, London's share of this being £39,163,660. Similar loans were floated in other currencies, notably in dollars, Swiss francs, and florins. On the following page is a tabulation of the sterling loans.

International co-operation did not extend to giving added protection to these loans except in the case of the Austrian Government Guaranteed Loan, where a joint guarantee was given by certain League States of both interest and principal. Guarantees were given by the following States in the following proportions: Great Britain, France, and Czechoslovakia, 24½ per cent each; Italy, 20½ per cent; Belgium and Sweden, 2 per cent each; Denmark and Holland, 1 per cent each. To make the guarantee effective, each guaranteeing State deposited with the National Bank of Switzerland, in the name of the trustees of this loan, its own bonds equal in amount to its guarantee.

Otherwise no special protection was given to League loans as such, but when, in 1932, default in whole or

	Date of Issue	Amount	Placed Abroad	Price per cent at which issued in London	Repaid up to Nov. 30, 1933	Balance Outstanding
		£	£	£	£	£
Austrian Government Guaranteed 6 per cent Loan*	June 1923	14,000,000	—	80	4,816,200	9,183,800
Kingdom of Bulgaria 7 per cent Settlement Loan	Dec. 1926	2,400,000	650,000	92	160,500	2,239,500
Kingdom of Bulgaria 7½ per cent Stabilisation Loan	Nov. 1928	1,800,000	300,000	96	20,900	1,779,100
Municipality of Danzig 7 per cent Mortgage Loan	April 1925	1,500,000	—	90	461,300	1,038,700
Free City of Danzig 6½ per cent (Tobacco Monopoly) State Loan	June 1927	1,900,000	760,000	91	609,150	1,290,850
Republic of Esthonia 7 per cent (Banking and Currency Reform) Loan	June 1927	700,000	200,000	94½	31,100	668,900
Greek Government 7 per cent Refugee Loan	Dec. 1924	10,000,000	2,500,000	88	579,000	9,421,000
Greek Government 6 per cent Stabilisation and Refugee Loan	Feb. 1928	4,070,960	700,000	91	100,280	3,970,680
State Loan of the Kingdom of Hungary 7½ per cent	July 1924	7,902,700	—	88	2,065,600	5,837,100
Total		£44,273,660	£5,110,000		£8,844,030	£35,429,630

* In December 1934 this was converted to a 4½% loan, and its term extended.

in part had occurred on all League issues except the two Danzig and the Esthonian loans, a League Loans Committee was formed in London, with Sir Austen Chamberlain as chairman of an international committee, with the object of protecting bondholders and safeguarding the special status of loans issued under the auspices of the League of Nations. The view of the committee is that these loans have a moral claim to special consideration, not only because the holders subscribed believing that the loans carried special privileges in view of the League of Nations backing, but also because without their issue the financial status of these countries could not have been restored, and the service on previous and future loans could never have been met. The money subscribed for League loans was not a great proportion of the total amount invested overseas through the London market between 1923 and 1931, but, by restoring a measure of confidence, these League flotations set foreign lending in motion again, and enabled a number of other foreign Governments to borrow in London for similar purposes. They also paved the way for the capitalisation of reparation payments through the German "Dawes" and "Young" Loans. The direct borrowing of Governments for such purposes is responsible for the largest proportion of money invested outside the British Empire during the last decade. The financial reconstruction which will be necessary before the freedom of the exchanges and normal international

trade is restored will necessitate further foreign lending of a similar kind. The necessity for deciding what steps are to be taken, and what protection given the bondholders, when this financial reconstruction becomes possible may easily be forced upon a Socialist Government. In view of their experience with League loans, investors are unlikely again to invest freely in the bonds of foreign Governments without the protection of their own Government. This had to be given in the case of the Austrian Loan raised in London in 1933 for the purpose of repaying to the Bank of England money lent when Austria's financial system was threatened with collapse after the failure of the Credit Anstalt. A guarantee of both principal and interest was given on this loan by the British Government.

Investment within the British Empire during the post-war period was responsible for a greater share of amounts invested overseas. Canada borrowed largely in New York instead of London, and Australia became the chief Dominion borrower in London. Money was raised, not only for constructive purposes, but also to meet interest and redemption payments, and Australian borrowing was on such a scale as to endanger her financial structure. From 1928 to 1932 the net increase in Dominion loans held in London was £73 million, while holdings of foreign loans decreased by £41 million.

To sum up, whereas before the war England, through foreign investment, was developing foreign countries and directly increasing or maintaining her

export trade thereby, in the post-war period her investment has been largely concerned with the reconstruction and stabilisation of Europe, with protecting existing interests elsewhere and increasing our interests in the British Empire. The European policy was largely due to the influence of Mr. Montagu Norman at the Bank of England, who realised that the country's prosperity was concerned with a Europe in sufficient financial health to trade with us. In this way our foreign investment policy has continued to be closely related to the maintenance of our foreign trade.

The table on pages 236–7 shows, as a result of these influences, the type of concern in which £1,969,571,000 of British capital was invested at December 1931.

It is interesting to note that, in the case of British companies, transport and raw materials and commodities are responsible for approximately four-fifths of the total, while in the case of foreign companies the amounts are more evenly spread, although in transport again the largest amount was invested.

4

Foreign investment takes one of four forms:

(1) Direct investment through new issues.

(2) The placing in London of foreign issues made abroad.

(3) The purchase of investments abroad.

(4) The purchase of international securities on the London market.

Functional Distribution of British Capital Invested

£000's

	British Companies		Foreign Companies		
	Share Capital	Loan Capital	Share Capital	Loan Capital	Total
Transport:					
Railways	244,455	270,401	78,035*	235,764	828,655
Shipping	12,050	6,312	5,359	811	24,532
Canals and Docks	1,377	2,222	1,616	2,491	7,706
Trams and Omnibuses	15,512	18,666	9,500	11,529	55,198
Total	273,394	297,601	94,510	250,586	916,091
Public Utilities:					
Electric Light and Power	7,758	6,841	13,297	32,192	60,088
Gas and Waterworks	13,485	3,229	29,734	2,163	48,611
Telegraphs and Telephones	23,948	4,349	5,871	12,406	46,574
Total	45,191	14,419	48,902	46,761	155,273
Mines	72,565	11,804	68,236	4,134	156,739
Raw Materials and Commodities:					
Iron, Coal, and Steel	7,609	2,130	13,048	8,858	31,645
Oil	107,514	12,852	24,500	—	144,866
Nitrates	3,372	1,747	2,997	5,045	13,161
Rubber	81,951	5,685	—	—	87,636
Tea and Coffee	38,610	2,542	—	—	41,152
Total	239,056	24,956	40,545	13,903	318,460
Commercial and Industrial	70,350	21,418	71,501	25,278	188,547
Banks and Finance:					
Banks	26,339	—	27,263	18,012	71,614
Financial Land and Investment	85,925	27,287	24,555	25,080	162,847
Total	112,264	27,287	51,818	43,092	234,461

* An underestimate. Kindersley's figures group together £29,734,000 share capital as applicable additionally to gas, water, and foreign rails. This figure is included in public utilities.

Abroad in British and Foreign Companies for 1931*

SUMMARY

£000's

	British Companies		Foreign Companies	
	Share Capital	Loan Capital	Share Capital	Loan Capital
Transport	273,394	297,601	94,510	185,197
Public Utilities	45,191	14,419	48,902	46,761
Mines	72,565	11,804	68,236	4,134
Raw Materials and Commodities	239,056	24,956	40,545	13,903
Commercial and Industrial	70,350	21,418	71,501	25,278
Banks and Finance	112,264	27,287	51,818	43,092
Total	812,820	397,485	375,512	383,754

SUMMARY:		£000's
	Transport	916,091
	Public Utilities	155,273
	Mines	156,739
	Raw Materials and Commodities	318,460
	Commercial and Industrial	188,547
	Banks and Finance	234,461
	Total	£1,969,571

* Since these figures were calculated, estimates for 1932 have become available. No significant change is apparent in the functional distribution, although the total is £45,000,000 higher.

The first is organised on the London market through merchant banking firms, of whom the chief are N. M. Rothschild & Sons, Morgan, Grenfell & Company, Baring Brothers & Co., Ltd., J. Henry Schroder & Co., Hambros Bank Ltd., and Lazard Brothers & Co. Ltd. The bulk of foreign issues floated on the London market pass through the hands of one or more of these five banks, the joint stock banks only occasionally acting as agents and only very exceptionally being responsible for foreign issues, although they may participate in them. In exceptional circumstances the Bank of England itself acts as the agent for the issue of loans, but generally only when the loan is floated under the ægis of the British or a Dominion Government. These merchant banks specialise in the finances of certain countries, maintain contact with them, collect interest, administer the sinking fund, and generally act as liaison between the investor and the debtor.

The placing in London of foreign issues made abroad has developed far more in post-war days with the rise in importance of New York, Zürich, and Amsterdam as international financial centres. The ban on foreign issues prior to the return to gold in 1926, and the unofficial control which has been exercised at times since, frequently prevented the issue of loans on the London market. As a consequence, foreign loans were often made in one of the other financial centres, but largely sold to financial institutions

and private investors in London by the merchant bankers mentioned, the London branches of foreign banks, and other concerns. In this way the larger portion of dollar bonds floated on the American market by European countries has at times found its way to London.

In addition, the investment policy of financial institutions, and to a small extent of individuals, has been to invest a portion of their capital in foreign securities with a view to protecting themselves against a fall in sterling or political disturbances at home. Large amounts were in this way invested in America and elsewhere to an extent extremely difficult to estimate. It is these investments, expressed as they are in foreign currencies, that it might be found necessary to mobilise in an exchange or other crisis. To ascertain accurately the holdings of British nationals abroad of this kind is probably not practicable, although much can be traced through remittances of income derived therefrom. The threat of severe penalties for concealment of foreign holdings when their declaration is demanded is probably the only effective weapon. Sir Robert Kindersley has estimated that the total of foreign issues made abroad and placed in London, but not marketable on the London Stock Exchange, and the holdings of British investors of foreign investments purchased abroad was in 1931 some £290 million. Heavy taxation and fear for the political and economic future of this country have

led to a growth in this form of investment in post-war days, and replaced to some extent foreign investment through the flotation of new issues on the London market.

In addition, there are a large number of international securities of foreign and colonial companies dealt in on the London market. These are often in the form of bearer bonds, and here again an estimate of their total is extremely difficult to make, and their control equally difficult. The fact that these are negotiable in several financial centres makes them attractive to tax evaders and international financiers. Any flight of capital which took place on the anticipation of a Socialist Government coming into power would use as channels (3) and (4) mentioned above. Control would only be effective through some form of exchange control dealt with elsewhere in this book.

The form of foreign loans issued in London varies greatly both as to security, conditions of issue, repayment, etc. In the case of foreign Governments a first-class borrower may not be called upon to provide any specific security for a loan which will be a first charge on the country. A country enjoying less worthy credit may be required to earmark certain revenues for service of the loan. This is a common form of security with lesser States, the usual revenue specified being customs or excise receipts, either in general or on particular goods. In exceptional cases, the collection of revenue may be put in the hands of officials under

the control of the country making the loan. This was the case in China up to 1928, when a treaty provided for tariff autonomy. Or, again, a special tax on certain goods or commodities may be imposed for the service of the new loan. In other cases the loan is charged against specific goods, as in the case of the San Paulo Coffee Loans, the service of which is met by a tax on all coffee brought to San Paulo and all port clearances. Loans are also charged on capital goods, such as railways and rolling stock, especially where bonds have been handed over in payment for work done.

The capital of British companies operating abroad differs little in structure from that of home concerns, and calls for no detailed analysis here. It is made up of debentures, preference, and ordinary capital. At December 1931, working from the figures (on p. 237), the percentage in loan capital was 32·8, and in share capital 67·2. This proportion does not vary greatly because, although provision is generally made for the redemption of loan capital, and certain repayments are made annually, foreign investment is a continuous process and new loans made are generally found to offset old ones repaid. This is advantageous, for the income received on loan capital is normally more regular, and its payment more likely to be made during periods of depression, than are dividends on equities. Its capital value is also liable to less violent fluctuations in value.

Kindersley estimates income of British holdings of foreign and colonial companies of a nominal share capital of £375,500,000 in 1931 at £22,654,000. Nominal issued capital fell by 5·3 per cent, while the fall on the previous year's income was 2·4 per cent. In the case of loan capital in 1931, £18,192,000 was received on £383,754,000. A fall in capital of 2 per cent took place in 1932 and a fall on the previous year's income of 5·9 per cent.

This country's total of foreign investments is estimated by Kindersley for 1931 as £3,410,454,000, on which an income of £155,513,000 was received. In addition, £26,752,000 was repaid during the year. The following table shows the different forms of security in which this was invested :

	1931 (in £000's)		
	Capital	Income	Repayment
Foreign and Colonial Governments and municipalities registered in U.K.	1,440,883	65,920	16,267
British Companies operating Abroad	1,210,305	48,747	4,900
Foreign and Colonial Companies registered Abroad	759,266	40,846	5,585
	3,410,454	155,513	26,752

Of the total 42·2 per cent was in foreign and colonial Government and municipal bonds. The remaining 57·8 per cent in companies whose securities are dealt in in London, operating or registered abroad, is divided into loan and share capital as follows :

(in £000's)	Loan Capital	Income	Repaid	Share Capital	Income
British Companies operating Abroad	397,485	15,451	4,900	812,820	33,296
Foreign and Colonial Companies registered Abroad	383,754	18,192	5,585	375,512	22,654
	781,239	33,643	10,485	1,188,332	55,950

Of the total of these classes of investments in 1931, 39·7 per cent was in loan capital and 40·3 per cent in share capital. If to the loan capital the Government and municipal investments be added, the total in fixed-interest securities is shown to be £2,222,122,000 or 65·1 per cent of total investments. The income on this in 1931 was £99,563,000, which is 4·4 per cent. The income on the total share capital of £1,188,332,000 was £55,950,000, or 4·7 per cent.

The table on page 245 shows how comparatively stable is the income from loan capital, and to what wide fluctuations the income on share capital is liable.

The main reason for the increased revenue receipts during 1932 was the premium received on conversion of gold currencies into sterling, including the dividends on South African gold mining companies. Since 1932 the fall in income has been checked, despite further foreign Government defaults, including the German transfer moratorium. The provisional figures of Sir Robert Kindersley indicate a decline in total of about £1½ million during 1933 compared with the drop of £11 million in 1932.

In the future, granted some measure of exchange stability, it can therefore be expected that there will continue to be a steady income receivable on British investments abroad, even if the trade cycle continues to operate; especially, as is shown later, as the decline in income to the end of 1932 was only approximately one-third of the total income. One reason why the decline has not been greater is the large percentage in the Government and municipal loans of the British Empire on which no default has occurred.

5

The success of foreign lending in its relation to the gold standard depends on two factors: the re-lending by the creditor countries of surplus income arising abroad, and the acceptance from the debtor country of imports in excess of the creditor's direct or indirect exports to him. The first was ignored by the United States in 1929, and was one of the factors precipitating the present economic crisis. The corollary of this cessation of investment abroad was the accumulation of gold and its sterilisation by America and France. The growth of economic nationalism on an increasing scale since England left the gold standard in 1931 has aggravated the collapse of foreign lending, leading, as it has, to the erection of barriers against imports, widespread default, loss of confidence, and destruction of credit. Economic nationalism is based on the assumption that a country's prosperity must be judged

PERCENTAGE RETURN ON BRITISH CAPITAL ABROAD

	Government and Municipal				British Companies Operating Abroad				British Capital in Foreign Companies			
	1929	1930	1931	1932	1929	1930	1931	1932	1929	1930	1931	1932
Income from Loans	4·58	4·50	4·57	4·35	4·75	4·49	3·89	3·47	4·90	4·95	4·74	4·56
Income plus Repayments from Loans	6·9	5·87	5·70	7·12	6·96	6·94	5·12	4·64	7·28	7·43	6·20	5·51
Income from Shares	—	—	—	—	8·44	7·23	4·09	3·55	9·63	8·10	6·30	6·42

by its balance of trade, that every country must have a favourable trading balance and no country an unfavourable one. The instruments used to effect economic nationalism are tariffs, quotas, and restrictions on trade, all of which lead to a curtailment in the volume of international trade, collapse of commodity prices, pressure on the exchanges, and default in payments by debtor countries. Any fall in world prices increases the burden of debt of all debtors, whether Governments, companies, or individuals. The South American States particularly, dependent as they were on the sale of primary products for the payment of their debts, during the present crisis were faced with the necessity of selling a far greater amount of goods to meet their indebtedness. The burden became insupportable, and default was unavoidable. The fall in prices and decreased demand for goods at a time when national policies were not only restricting imports, but also causing a contraction in purchasing power through deflation, caused decline in the favourable trade balances of the debtor countries, and demand for foreign exchange to meet obligations became greater than supply. The depreciated exchanges which followed added further to the burden of debt, which finally became insupportable, especially as the obtaining of new loans was out of the question. This exchange crisis affected all debtor countries, internal taxation, and even accumulation of surpluses, being of no use when the creditor country

refuses both to accept goods and to make further loans, and thus makes the acquisition of foreign exchange impossible. Default in whole or in part among many debtor countries has resulted. In South America, for instance, Argentina alone up to the present is meeting the interest on her foreign debt payments in full. But, compared to the total invested abroad, default is not so great as appears on the surface. For instance, a rough calculation shows that from January 1, 1930, to January 3, 1933, default took place on a nominal amount of £133,651,897 of foreign Government and municipal bonds officially dealt in on the London Stock Exchange. On these bonds interest was in arrears to the extent of about £10,109,381, and default in sinking fund payment amounted to £5,024,992. Proportionately this is not considerable, as the total British capital in Government and municipal stocks in 1931 was £1,440,883,000, part of which, of course, was already in default. But this default only partially affects British investors, as large portions of these bonds are held by foreigners abroad. During 1933 many more defaults have occurred, including a declaration of a transfer moratorium on German bonds.

The procedure followed by many defaulters has been similar. Payment on foreign indebtedness has been met in local currency, the amount due being paid into an account earmarked for service of the debt. In some cases holders of bonds can draw the

local currency and use it to make payments in that country, reinvest it there, or use it for other specified purposes. As a result, there has grown up a market in these "blocked" accounts at rates of exchange considerably below parity or the official nominal quotation. Some Governments have facilitated the liquidation of these blocked accounts by permitting their use for the financing of exports. In such cases the procedure is to allow payment for goods produced for export to be made in the blocked currency. The English importer of goods from Hungary, for instance, will buy on the unofficial market coupons or bonds which are payable in the blocked currency—in this case pengos—encash the coupons in pengos at the Hungarian bank, and pay for the goods he wishes to buy with them. Germany has done the same with certain categories of blocked marks, allowing the exporter to obtain cheap marks to the extent of the difference between his price and that of the competitor whose currency is depreciated. Germany has admitted the principle that foreign payments can only be made in goods, and to the extent that a country increases its purchase of German goods interest payment will be made in full. In this way, Dutch and Swiss holders of German bonds were receiving 100 per cent of the interest due, when English holders were receiving only the equivalent of about 75 per cent. Not only have Government defaults affected the income now being received from abroad, but the embargo on

foreign exchange remittances has prevented English companies operating abroad paying interest and dividends to shareholders, even where it has been earned. Large balances are accumulating in foreign currencies to the credit of English concerns.

The following figures, based on Sir Robert Kindersley's estimates, show decline in income :

INCOME FROM FOREIGN INVESTMENTS

	(£000's)	Income as percentage, taking 1929 as 100
1929	230,875	100
1930	209,005	90·53
1931	168,737	73·09
1932	156,400	67·74
1933	154,900	67·09

One reason for the slowing down of the decline in 1932's income, which is a provisional estimate based on capital outstanding at December 31, 1932, is the rise in the price of gold and the increased sterling receipts from South African gold mines. No further decline is considered likely to have taken place during 1934, there being few further defaults or increases in transfer moratoria, although some conversions to lower rates of interest took place, and reserve funds and balances which were drawn upon to make partial payments became exhausted. This decline in income from abroad must be followed by a decline in imports, which will be welcomed by those who judge prosperity by the visible trade balance. The fall in imports must lead to a reduction in the

volume of goods available for consumption, a fall in the national income, and a reduced standard of living. More is to be lost through the decline in our imports through the fall in value of our resources than through a so-called unfavourable balance of trade. On the other hand, the fall in imports need not be as great as the decline in money income, as the price-level has also fallen.

This widespread failure to remit payment on foreign indebtedness has assumed unique characteristics. Much past foreign lending is proving unprofitable ; not necessarily because the countries to which money has been lent are unable to raise revenue to meet their indebtedness, nor because the companies built up with British capital abroad have become bankrupt, but because of a breakdown in international exchange. Corporations and individuals are in possession of large sums of foreign currencies for which they have no use, and which they cannot turn into cash, or, if they can, only at much below its nominal value. This accumulation of blocked currencies through transfer moratoria makes the resumption of foreign lending, so essential to the restoration of international trade, far more difficult. The release of blocked currencies can only be effected through increased export, cancellation, or further lending. To the extent that currency is disposed of at low rates and indebtedness is reduced through re-purchase of the bonds by debtor countries at current low quotations, the position is improved, but the accumulation of

blocked currencies goes on. The importance of this to a future Socialist Government lies in the fact that the liquidation of this position must take place over a very long period. A Socialist Government may, therefore, have to decide which of the three possible paths mentioned above is to be followed, and whether further lending to release existing accumulations will be justified in terms of trade, purchasing power, and the standard of living.

How liquidation can take place is demonstrated by the trade agreement with the Argentine. In return for certain tariff and trade concessions, a loan of £10 million was raised in London, the proceeds being used to liquidate the Argentine peso balances held in the Argentine by English companies operating there. Confidence in foreign investment being absent and Argentine credit low, a complicated scheme was devised to place this loan. In exchange for peso balances, British companies received bonds of a 4 per cent Argentine sterling loan. To enable these bonds to be encashed, the United Kingdom and Argentine 1933 Convention Trust was formed. Holders of £7,156,100 of the 4 per cent Argentine Loan deposited their bonds with the trust, which purchased £5,367,075 of British Government 3 per cent Conversion Loan. Holders received partly cash and partly a unit in the trust, which was now represented by British Government and Argentine stock. It is unnecessary to go into the complicated details of the

trust's make-up, but, in effect, by mixing British Government stock with the Argentine loan the trust was able to market its units through the London Stock Exchange, which enabled the original holders of peso balances, totalling $171,581,423 of Argentine paper, to turn them into sterling. As a consequence, many debenture and preference shareholders in Argentine railways have received interest and dividend payments which otherwise would have been impossible. It is interesting to note that this Government assistance to holders of Argentine securities took no cognisance of the economic state of the Argentine. At the very time that these bonds were in this indirect way being marketed on the London Stock Exchange, figures were published showing a substantial decline in Argentine trade and a diminution in her export balance. The Government thereby assisted existing holders of peso balances to get sterling in exchange, but only by passing the Argentine risk on to a fresh lot of investors through the Argentine Trust.

While liquidation in some cases can be effected in this way, and in other cases partial resumption of payment may eventually take place, it is inevitable that a large part of British investment abroad will have to be written off as lost. Once stabilisation of currencies has been achieved and steps are taken to restore the freedom of the exchanges, a new estimate of our foreign holdings will have to be made, based on current instead of nominal values.

6

Because there is likely to be a flight from sterling and export of capital immediately there is the possibility of a Socialist Government coming to power, and because foreign investment is an integral part of the country's economic structure, the Government will in its earliest days have to define its attitude both to existing holdings abroad and to future investment. To stop the flight of capital, a ban on foreign issues in London will be insufficient, as the export of capital could proceed through the other channels already referred to. In the first instance, complete exchange control would be necessary. In addition, to prevent a transfer of securities which enjoy an international market abroad their removal from the country would have to be prohibited, provision being made for foreigners to remove securities on proof of ownership. Eventually the declaration by financial institutions and individuals of their holdings abroad would have to be made, but whether this will be necessary in the early stages of the transition period will depend upon the effectiveness of exchange control and the effect of a Socialist Government upon the economic condition of the country, particularly as regards international trade. That is a matter of foreign exchange control which has been dealt with elsewhere. Here, all it is necessary to discuss is what is to be a Socialist Government's policy with regard to existing foreign

investment, and to the making of further investment abroad.

The task of a Socialist Government will be the improvement in the standard of living of the unemployed and of the workers generally ; the creation of employment through the restoration of trade will, therefore, be one of its first objectives. For reasons already given, the protection of existing investments and further lending can be of material assistance in the achievement of this aim. The liquidation of blocked currencies through the granting of further credits to countries whose exports to this country of primary products are of such importance, credits to such countries as the U.S.S.R., who are in need of capital goods manufactured here, loans to aid other countries to restore their broken finances so that trade can be resumed—in these and other directions foreign lending can assist in the immediate creation of employment.

Whatever may be the position of exchange control, from the day the Socialist Government takes over, all foreign investment must be under the absolute control of the Government. Because of this, I do not think it necessary to discuss such deterrents to foreign investment as additional taxation on income received from foreign investment or higher death-duties on foreign holdings. Such differential treatment would be an additional inducement to conceal foreign holdings and make eventual acquisition more difficult. It might also lead to liquidation of investments abroad which

might not be of economic advantage. A Socialist Government would, presumably, sooner or later impose heavy taxation on unearned income and increasingly high death-duties on private capital, and there would be little justification for differentiating between capital employed at home or abroad. At a later stage, however, when British companies are being subject to State control, some additional taxation on income received from companies registered abroad might be necessary to prevent holders of these securities enjoying more favourable treatment than investors in British companies operating abroad but registered at home.

I believe that the only possible foreign investment policy for a Socialist Government is the uncompromising one of making it a Government prerogative. There should be no loans to foreign Governments, no fresh investment abroad, no import or export of international securities, without Government consent. Only such a policy would enable the volume and direction of foreign investment to be related to any general economic plan which may be decided upon.

Government control being complete, what is to govern the foreign lending policy? Assuming there were a surplus to lend abroad, what should govern the allocation of this surplus as between non-Socialist States, Socialist States, and members of the British Commonwealth of Nations?

Non-Socialist States.—Fortunately, our importance

both as an importer and a potential lender should prevent any action against our foreign monetary possessions by capitalist Governments. Confiscation by foreign Governments of British-owned properties (such as Argentine railways), for instance, is unlikely. The need for further credits and the size of the British market for primary products prevents this being an immediate probability.

The necessity to liquidate accumulated balances and to grant further loans to restore international trade would be linked up with our foreign trade policy. Under Socialism, foreign investment would be primarily governed by this policy of increasing the volume of imports and exports, and not by the desire to make individual profits, which governs the direction of investment to-day. Loans would only be granted where interest and repayment could be paid through the export of specific commodities to this country, in accordance with any import quotas fixed. A foreign trade monopoly would greatly facilitate this. Tariff concessions on British goods to facilitate accumulation of foreign exchange to effect remittances could also be sought. With non-Socialist States, the achievement of monetary and trading equilibrium is most likely to be arrived at through the conclusion of treaties, the Anglo-Argentine treaty, referred to earlier, having set a precedent and model which can be followed and very much improved upon. To restore economic equilibrium, foreign credits on a large scale will be

needed. It will only be possible to raise these through the co-operation of the chief creditor countries, whose credit will have to be used as a backing to the loans. Possibly the League of Nations, through the Bank for International Settlements, would be the best medium for arranging and administering such loans.

Socialist States.—In the case of countries such as the U.S.S.R., the aim should be the greatest possible volume of trade consistent with mutual advantage. Long-term export credits, liquidated through imports, and long-term loans, not necessarily carrying trading advantages, direct to the Governments concerned could more readily be granted, it being far easier to negotiate with a country which has a monopoly of foreign trade than with non-Socialist States where anarchic trade conditions still prevailed.

The British Empire.—The extent to which loans for development purposes could be made to the British Dominions would be linked with colonial policy. Here again the necessity to protect that vast volume of investment already made would make the issue of further loans inevitable. For internal purposes the Dominions are able to borrow on an increasing scale from their own nationals, but as yet they would still have to come to London were any large schemes of development undertaken. Because the credit of the Mother-country is behind them, Dominion loans floated on the London market have attained a higher status than their economic or financial condition

justifies. It is assumed by investors that England would never allow a member of the British Commonwealth of Nations to default. Holding this view was justified in the case of Newfoundland, whose liabilities were assumed by the British Government in December 1933, when that country was faced with financial bankruptcy. The Dominions can consequently borrow in London on far more favourable terms than many foreign Governments whose finances are in equal or even better condition. Australia, for instance, during 1933 converted £88,212,536 of high-interest-bearing debt into low-interest debt, service on which costs only about ½ per cent more than that on British Government loans. In return for this advantage, conditions should be attached to any loans made. These conditions could be more compelling in these cases than when loans are made outside the Empire. Apart from such conditions as regards the spending of a portion of the money at home and the like, which are referred to later, considerable political demands could be made. The granting or withholding of loans might prove an invaluable weapon in bringing recalcitrant Dominion Governments to heel where they are still under capitalist influence and are not willing to fall in line with the Socialist policy of the Mother-country.

Normally, no new private firms would be allowed to raise money for the British Empire on the London market; but public corporations and semi-public boards of the Dominions would be enabled to do so if

the necessary consent were obtained. It would be necessary to know precisely for what purpose the loan was required, and how and where the money was to be spent. All other monetary requirements of the rest of the British Empire on London would have to be provided with the aid of the British Government. Loans of crown colonies, protectorates, etc., often carry the guarantee of the British Government; and this policy would have to be continued, as the raising of the money by the colonies themselves would be over-burdensome to them. As private enterprise would be increasingly discouraged by a Socialist Government, permission would only exceptionally be granted to new companies to raise money for colonial development, and then some measure of control would have to be retained by the National Investment Board. A Socialist colonial policy would no doubt encourage development carried on with the aid of, or under the control of, the Government.

To sum up: Investment in non-Socialist States would be guided by the requirements of foreign trade and the necessity for protecting existing investments where the maintenance of imports was necessary to our standard of living. Between Socialist States, foreign investment would be used as a means of increasing to the maximum extent possible mutual interests, both economic and political, while, in the case of the British Empire, investment policy would be framed with a view to carrying out the Socialist

colonial policy for moulding the British Empire into a true Commonwealth of Nations.

As foreign investment policy is so intimately bound up with foreign and colonial policy, with questions of trade, and with the general economic position of the country, particularly as regards balance of payments, its control must be by a body able to co-ordinate all these factors. Labour policy provides for the establishment of a National Investment Board. This board will control the raising of capital and the allocation of savings, and would be the natural body to control the investment of money abroad. This body will either have among its members representatives of the Treasury and the Bank of England or be in constant consultation with those institutions. A department of the National Investment Board, in constant touch with other bodies concerned, could control foreign investment. From this body all foreign and colonial Governments and British and foreign companies operating abroad, desirous of raising money, would have to obtain permission before obtaining fresh capital. In relation to general policy, each request would be considered on merits. The board would have to learn exactly for what the money was required—for Government development, for conversion of existing loans, to finance trade, etc. It would be necessary to ascertain where the money was to be spent, in England or abroad, and the board would then examine the matter in relation to the existing state of trade with

the country concerned. If the money were required for the purchase of capital goods, it would probably be stipulated that a proportion at least of the funds were spent in this country. A loan might be refused if it were required to finance the establishment of industries in countries where the standard of living was much lower than at home, resulting in competition in British markets with goods produced under bad conditions. In fact, in certain instances it might be found advisable to insert fair labour clauses into loan conditions where this was feared. No loans would be granted which entailed the exploitation of one race by another. But this policy must not prevent loans to backward countries as such, as it is these countries with the lowest standard of living that are in greatest need of foreign credits, the obtaining of which can alone lead to development. A successful Socialist Government might easily lead to a curtailment in foreign lending, for, if Socialism is successful in improving the standard of living, the costs of British goods might rise to such heights that debtor countries might be able to purchase them cheaper elsewhere. This makes it essential to attach strict conditions as to the use to which borrowed money is to be put. Failing this, London might easily become simply the financier of the trade of other countries—which has been remunerative to the City of London but of little use to the rest of the country.

It is not possible to stipulate precisely what loans a

Socialist Government would make and which refuse. It would be mainly a question of policy and expediency. The National Investment Board would act as a clearing-house for all investment abroad. Permission granted, large Government loans which fitted into governmental policy could be issued direct to investors, as now, through the London market. Existing companies could increase their capital in the same way, though here the National Investment Board would have to be provided with figures as to the manner in which profits earned abroad were disposed of, in order to ascertain that capital was not being accumulated abroad in defiance of regulations. For this reason all British companies operating abroad would have to be carefully watched, and their accounts periodically examined. Otherwise accumulation of reserves and balances abroad could go on unchecked. Nor would permission be given to borrow in London in order to distribute in sterling profits accumulating abroad which the company desired to refrain from bringing over.

This raises the question of the disposal of any annual income and repayments made on foreign investments. To-day this, in effect, provides the funds for further investment abroad. Its distribution in foreign currency —as is being done already in some cases owing to exchange difficulties—might lead to evasion of English tax and restrictions by those desirous of increasing their holdings abroad. This would have to be taken

into account in estimating the annual surplus available for investment abroad, and, if restriction of it were desirable, that would be the concern of those in control of foreign exchange.

Where requirements for capital were small the National Investment Board might itself make the advance. The board will also function as a large investment trust raising money through the issue of its own bonds. But no loan would be made without a measure of control being obtained in return, as no aid could be given to inefficiently run industry.

The board might also acquire foreign investments through payment of death-duties in securities instead of cash. If the board were particularly desirous of acquiring foreign investments for reasons of policy, more favourable terms than market valuation might be offered. For the board, control of the raising in London of money for abroad should present no insuperable difficulties. The control of investment abroad made through other channels, particularly through the purchase of securities on foreign markets, is far more difficult. This will necessitate some permanent measure of exchange restriction, if a complete ban on the purchase of foreign securities abroad is not found necessary.

Government control through the National Investment Board working in conjunction with the Bank of England, the Treasury, and the Government departments concerned with matters of foreign and colonial

trade and relations ; the volume and nature of investment governed by foreign and colonial policy as well as economic considerations, and by the necessity of maintaining the existing standard of living ; and the granting and withholding of credit as a weapon for obtaining trading and other concessions based on a *quid pro quo* policy—such would be the general lines of foreign investment policy during the transition period.

Ultimately, because Socialism and Imperialism are inconsistent, it may be necessary for a Socialist Government to liquidate the foreign investments of its nationals. The taking over of the investments, and the giving of National Investment Board bonds in exchange, would enable the sale of British-owned enterprises abroad to Governments, in order to eliminate absentee ownership and foreign exploitation. Payment could be made by the foreign Government either in its bonds, which could be held by the National Investment Board, or through goods, and liquidated through increased trade. This would facilitate the passing of foreign undertakings from foreign private ownership to national public ownership, a policy which a Socialist Government would wish to encourage. Any further investment abroad would then consist solely of loans made direct to foreign Governments. Such development of Britain's role as a foreign investor is, however, in the far future.

THE PROBLEM OF FOREIGN EXCHANGE CONTROL

E. A. RADICE

THE PROBLEM OF FOREIGN EXCHANGE CONTROL

After the experience of July 1931, there is a widespread feeling in the Labour Movement that vigorous action on the part of an incoming Socialist Government may be prevented, or at least endangered, by financial panic on the part of British and foreign capitalists, which would result in a flight from the pound. My purpose here is to discuss some of the problems which this might entail, and the means by which it might be prevented. How serious the danger is cannot at the moment be calculated, but in any case it is a danger which a Socialist Government might be called to face, and to meet which a considered plan of action must be prepared beforehand. Fortunately, the recent experience of a number of foreign countries gives us some clue as to the kind of action which would be required.

There are some Socialists, indeed, who say, " Why worry about a flight from the pound? We have our land, our factories, and our machines, which cannot be taken from us." This is all perfectly true, of course, but the fact remains that serious hardships would occur if the pound fell considerably in value. Our imports would, in the first place, become more

expensive, and, even though there might be certain stocks available within the country, rises in prices would inevitably follow. Secondly, our exports would fall in price, and, while this might stimulate their total volume and create temporary extra employment in the export industries, it would mean a corresponding loss of wealth to the country, for which no return was being obtained. Thirdly, foreigners would be enabled, if the pound fell considerably, to buy such assets as British ships, securities, assets abroad, etc., at bargain prices. While a moderate depreciation in the external exchange value of a currency may, in a capitalist economy, give a stimulus to employment, in a Socialist economy properly organised internally, and with its foreign trade centrally controlled, it is otherwise ; for then the essential problem is to see that for that part of the product of labour which is exported an adequate return in consumable imports is obtained. Finally, even under capitalism, currency depreciation on a large scale has always caused most distress to those members of the community who are worst off. We must therefore reject the facile suggestion that currency depreciation does not matter, and instead make plans for the regulation of foreign exchange.

With the political and constitutional difficulties of an incoming Socialist Government I am not here concerned. I shall assume, however, that a financial panic in the form of a flight from the pound is taking

place, with which the Government must immediately deal. I shall also assume that emergency powers have been taken to bring under Government control the main financial institutions of the country, including powers to close or regulate all banks, financial houses, the Stock Exchange, etc. (For suggestions as to the actual form of such Emergency Powers Act see a pamphlet by G. R. Mitchison, *Banking*, issued by the Socialist League, 6*d*. In actual fact, when capitalist Governments have been faced with financial panics they have never hesitated, when necessary, to close down all financial institutions temporarily.) The problem, then, is to discuss what actual steps are to be taken after the financial institutions (many of them including the Bank of England and the joint stock banks still under Government control) have resumed their ordinary functions. It is safe to assume, further, that the country will be off gold standard—i.e. that there is an embargo on gold exports—for, even assuming that the gold standard were operating immediately before the crisis, it would certainly have been suspended as a first emergency measure.

Now there seem to be three things which our policy must be framed to avoid :

(1) A rapid fall in the external value of the pound.

(2) A relatively overvalued pound, which would encourage rather than discourage a withdrawal of assets by foreigners.

(3) Too rigid exchange restrictions, which might temporarily cripple our foreign trade before we had time to set up Socialist bodies to manage it.

The Government must therefore be able to get control of the situation and have sufficient resources to fix the value of the pound in accordance with its general policy, and not be at the mercy of outside speculative forces. Obviously, then, it must have a monopoly of foreign exchange dealings. No doubt it will be in practice impossible totally to eradicate "black markets" (see Appendix B) at home and abroad, in which transactions will be put through at unofficial rates, but the technique which has been worked out in many countries in the last two years gives some indication of how these can be reduced to a minimum, if not suppressed altogether. I prefer first to consider the factors which affect exchange rates, and how easily they can be controlled, and then to suggest quite shortly some general proposals regarding the actual machinery of control.

The transactions affecting the exchange value of the pound may be divided into two main classes: (1) those on capital account, and (2) those on income account. I propose to treat these separately, and retain this division, except that I shall include under the first heading gold (but not silver) exports and imports, and under the second heading ordinary repayments of capital by way of sinking funds, etc., in respect of British capital invested abroad.

CAPITAL TRANSACTIONS

These consist of transfers of bank balances between this and other countries, and purchases and sales of foreign bills by this country or sterling bills by foreigners (short-term items) ; and purchases and sales of foreign securities by this country and British securities by foreigners (long-term items). Of these, the short-term items are, from our point of view, the most important, because, since bank balances and bills are "liquid," and not, in general, subject to fluctuation in their own currency values, they can most easily be quickly transferred. Securities, on the other hand, are not all so easily transferred, and are, of course, subject to Stock Exchange fluctuations. A further important factor to bear in mind is that, while this country is a very large creditor on long-term capital account, it is quite frequently a debtor (and has till quite recently been a very large debtor) on short-term account.

Short-term Assets.—These form an important liquid fund which, if mobilised, can be used to support the sterling exchange when necessary,and particularly to counteract the withdrawals of short-term assets by foreigners. The most important of them—and these, fortunately, are already under Government control—are the gold holdings of the Bank of England and the assets of the Exchange Equalisation Fund, which now,

in 1934, may be worth, in present sterling values, not far short of £400 million.[1] Secondly, there is a volume of acceptances on account of foreigners—i.e. credits granted to foreigners by British banks, acceptance houses, etc. These may be anywhere between £100 million and £150 million (at December 31, 1928, they were over £200 million), but a large proportion of them is "frozen" in Central Europe, and they are not therefore easily realisable to serve as a fund to offset exchange depreciation. On the other hand, this item should easily be controllable, since acceptance credits are granted by a known number of banks and acceptance houses, whose credit operations are even now under the eye of the Bank of England.

A more difficult item is foreign cheques and bills, and balances held with foreign banks. Where these assets are held by banks, their control obviously depends on the amount of control that is taken over the banks themselves, but the holdings of individuals and private firms present a harder problem. All that can be done in the short run is to require all holders of such foreign assets to report their holdings to the authorities, who would have the right to acquire them at current rates of exchange. Severe penalties should attach to failure to report. (It is interesting to notice that, by fixing very severe penalties on gold hoarding, the U.S. authorities were able to acquire a very large

[1] At a gold price of 120*s.* per oz., the value of £180 million of Bank of England gold is about £232 million sterling.

quantity of gold from private hoarders. The maximum penalties, however, must be very severe.) It is obvious that some firms and private persons (particularly importers) require a certain amount of foreign short-term assets to finance their trade requirements. In the case of any shortage of foreign exchange, these would have to be rationed by the authorities.

Short-term Liabilities.—These consist in foreigners' holdings of sterling bills, balances with British banks, advances to the discount market, etc. Before the departure of this country from the gold standard, their amount was about £400 million to £500 million, and, though this has no doubt diminished considerably since then, it is still a problem. Germany, whose main creditors were a comparatively small number of large foreign banking firms, was able in 1931 to solve her immediate problem by negotiating standstill agreements. The case of this country is, however, rather different, since our creditors are probably rather smaller in size and certainly very much larger in number. Nor is it advisable for political and trading reasons to prevent foreigners withdrawing their assets should they want to do so. The best course to follow is to meet the run on this country by foreigners with what foreign assets and gold lie at our disposal. It would be advisable, however, to allow the sterling exchange to fall somewhat if such a withdrawal did take place, because this is, after all, the best way of

checking the run, or at any rate of keeping it within reasonable limits. In any case, we should be well rid of much of these short-term debts to foreigners, and any revival of confidence abroad, or decrease in the volume of Treasury bills in this country, would to some extent ease matters. (The withdrawal of assets by foreigners obviously presents a rather special difficulty. It is probable that the greater part of the withdrawals would take place before exchange control was actually operating, and it is also clear that foreigners would desire to keep some sterling balances to meet current trading requirements. If, as is suggested, foreigners were allowed to withdraw their balances, it is necessary to prevent "gifts" being made by British nationals to foreigners. The best way of dealing with the problem would be to set up a tribunal to which foreigners holding sterling balances, etc., might apply for foreign exchange. They would be required to produce evidence that these balances were temporary investments in this country, and that they had held such and such amounts immediately before the crisis. Similar regulations could apply to foreigners holding long-term British securities. See pp. 275–6.)

Long-term Assets.—These are very large in volume—perhaps some £3,000 million at present values—and may be divided into four classes :

(*a*) Overseas investments in sterling and registered

in London—e.g. most Dominions and Colonial stocks, Argentine Railways, etc.

(*b*) International securities held by British investors in the form of *bearer* bonds, etc.

(*c*) Other overseas investments, registered abroad.[1]

(*d*) Holdings by British companies in overseas subsidiaries.

It is unlikely that these items could in the short run considerably affect the foreign exchange situation, as in many cases these securities can only be realised at a considerable loss. It is desirable, however, that the authorities should have some control over these items, so that if possible they could be "mobilised" to form a foreign exchange reserve. (There is, of course, the political problem of whether it is desirable for a Socialist State to have any foreign investments.) Holders, therefore, would have to be required to declare their holdings of overseas investments. To a large extent these can be checked from the Inland Revenue returns, but it is clear that some of the four classes can be controlled more easily than others:

(*a*) With proper control of British financial institutions this class of overseas investments can be

[1] Sir Robert Kindersley (*Economic Journal*, June 1932, p. 193) points out that only securities in *this* class could be suitably used to protect the exchange. Their amount he calculates was some £550 million in 1930, or rather less than one-sixth of the total investments abroad. The fact, however, that a large proportion of these securities is held by investment trusts and insurance companies makes their mobilisation somewhat easier.

checked up, since the books of the fiscal agents of the various issues could be made available.

(*b*) A prohibition of the export of bearer bonds would prevent items in this class from being sent abroad to escape control.

(*c*) The only possible check here is, ultimately, the returns of the Inland Revenue.

(*d*) A certain amount of control could be exercised here by the institution of a public audit for all companies. This is obviously a step which could not immediately be carried out.

The acquisition of further foreign securities by persons in this country would clearly have to be controlled. The experience of other countries shows that this is not a difficult matter as far as private persons are concerned, if there is central control over all foreign exchange dealings.

Long-term Liabilities.—These are probably not excessive in amount, and represent holdings of British securities by foreigners. Selling of them might involve considerable loss if Stock Exchange values were slumping, but the proceeds of such sales could be converted into foreign currencies by foreigners, provided sufficient proof was furnished that the holding was a holding by a foreigner. The sterling balances arising out of the sales of such securities would, of course, be subject to the conditions laid down on pp. 283–5.

INCOME TRANSACTIONS

The object of foreign exchange control is, after all, to ensure that the country can import sufficient quantities of the goods and services it needs in exchange for the goods and services which it exports, and to ensure that the exchange is carried out on equitable terms. In the long run our visible and invisible imports cannot exceed our visible and invisible exports, and for the success of any national plan it is essential to see that any claims on foreigners which are created by our exports are available for the purchase of imports. So long as foreign trade is not a State monopoly, this can only be brought about by exchange regulations which will enable the State to secure foreign exchange arising out of visible and invisible exports.

It may be said that any foreign exchange control of this nature will merely serve to strangle international trade, as it undoubtedly has done when put into force by capitalist countries, particularly when such countries have been debtor countries. It must be remembered, however, that the object of exchange regulations in these countries was nearly always to restrict imports as such, while the exchange regulations of a Socialist Government should be designed to secure the largest possible volume of those imports which will serve industries and raise the standard of living of the workers. The object of our exchange

control will be primarily to prevent panics and large transfers of capital, and not to restrict imports. In any case, the greater the amount of foreign exchange which the central authority can acquire on account of exports, the less need will there be for rationing imports. How far it is possible to acquire control of such income will now be considered.

Visible Exports.—The securing of foreign exchange obtained from the sale of British goods abroad is probably not as difficult as it seems at first sight. The experience of Germany in this respect is certainly encouraging (for an account of the measures taken in Germany see Appendix A). The general object must be to prevent exporters from accumulating foreign balances abroad instead of changing them into sterling. Once the machine has been got to work (see p. 282), this can pretty well be secured if every exporter sending goods out of the country is made to report to the customs authorities the value of the goods, and then settle up with the exchange authorities within a certain period. The case of exports " on consignment " presents some difficulty, but seems to have been dealt with successfully in Germany. An additional check would have to be applied, no doubt, to prevent exporters from under-invoicing their consignments.

Shipping Income, Banking, and Insurance Services, etc.—Income from these services presents some difficulty.

In the case of banking and insurance, nationalisation would give adequate control so far as the income of the nationalised banks were concerned. The greater part of such income to-day, however, is earned by the smaller banking institutions and the insurance companies, and can probably only be adequately controlled if there is some control over these institutions themselves. In any case, it is probable that the advent of a Socialist Government in this country would reduce the income obtained from these services.

Income from shipping presents a similar difficulty, but is more important because there is no reason to suppose that it would not continue at a high level. The only adequate solution is again to bring the shipping industry under public control. Much of this income is, however, included in the examination of income from overseas investments which follows.

Income from Overseas Investments.—Leaving aside the political question of whether a Socialist State ought to have overseas investments, it is obvious that in the period immediately following the crisis it is at any rate desirable for the central authority to have control of what income does come in. The same, of course, applies to repayments (mainly through the operation of sinking funds) of capital invested overseas. It is necessary to ascertain how easily control could be obtained over these items, and for this purpose Sir Robert Kindersley's figures for 1931 will be used (*Economic Journal*, June 1933) :

Group I

Foreign and Colonial Government and Municipal Stocks and Bonds.*

	Payable in U.K.			
Type of Security	Income £000's	%	Amount £000's	Repayments £000's
Dominion and Provincial Government	44,145	88·8	39,201	2,568
Dominion and Colonial Municipal	4,260	89·8	3,825	2,939
Foreign Government	15,715	54·2†	8,518	10,139
Foreign Municipal	1,800	74·7	1,345	621
	65,920		52,889	16,267

Group II

Capital Invested in Companies Operating Abroad and Registered in U.K.

	Income £000's	Repayments £000's
Dividends	33,296	—
Interest	15,451	4,900
	48,747	4,900

These securities constitute the main body of capital directly under British control. Since they are registered in England, the problem of securing the income from them should not present great difficulties.

* Defaults in this group in 1932 are calculated by the Board of Trade at £5 million.

† The low percentage for foreign Government securities is in large measure due to the payments made in London in respect of foreign *tranches* of international issues, as well as sterling issues placed abroad. In case of most of these securities, coupons are cashable not only in London, but also abroad, at the option of the holder, and these present a special problem.

Group III

Capital Invested in Companies Operating and Registered Abroad.

	Income £000's	Repayments £000's
Dividends	22,654	—
Interest	18,192	5,585
	40,846	5,585

The problem of securing the income from these securities is a much more difficult problem. It might be partly solved by using the information available at the Inland Revenue, and also by obtaining some control over insurance companies and investment trusts.

British overseas securities can, therefore, be divided for our purposes into : (*a*) those which are registered in this country ; and (*b*) those which are registered abroad. The income and repayments from the former can probably be controlled fairly easily. The following table of 1931 figures summarises the position :

	Income £000's	Repayments £000's
(*a*) Group I (part)	52,889	13,051*
Group II	48,747	4,900
	101,636	17,951
(*b*) Group I (part)	13,031	3,216
Group III	40,846	5,585
	53,877	8,801
Grand total	155,513	26,752
Of which :		
Payable in U.K. (*a*)	65·4%	67·1%
Payable abroad (*b*)	34·6%	32·9%

* It is assumed that the proportion of repayments in London is the same as the proportion of interest so payable.

THE ORGANISATION OF EXCHANGE CONTROL

The actual organisation of the foreign exchange monopoly which will be set up cannot be determined in great detail beforehand. The following tentative suggestions do, however, give some indication of the type of organisation that will be necessary.

At the present moment there are probably some thirty firms in London, large and small, which can be called foreign exchange dealers. They depend for the larger part of their business on the joint stock banks, and the foreign, dominion, and colonial banks situated in London, and to a smaller extent on the merchant banking houses, Stock Exchange firms, etc. Their nationalisation would not therefore be a difficult matter if : (*a*) the Bank of England and the joint stock banks were nationalised ; (*b*) other financial establishments were allowed to work only under licence, as suggested by G. R. Mitchison in his pamphlet on banking (loc. cit., pp. 8 f.).

Foreign exchange dealings would then be made a Government monopoly, and severe penalties could be placed on any unofficial transactions. It would be necessary, however, in view of the close connection which would have to be maintained between the exchange authorities and the exporters and importers, to have branches throughout the country to which exporters would have to report, and from which importers could obtain their exchange requirements.

In Germany, branches of the Reichsbank and local taxation offices have been used for this purpose (see Appendix A), but in England it would clearly be more convenient to use the nationalised joint stock banks. It would probably be best to concentrate all foreign exchange dealings in one of the "big five," whose branches would undertake this business all over the country. The foreign exchange departments of the other banks could be transferred to this bank, and much duplication of work could be avoided. Similar arrangements could be made for Scotland and Northern Ireland. In this way the needs of local exporters and importers could be met, and the dangers of over-centralisation avoided.

THE FIXING OF EXCHANGE RATES

The fixing and regulation of the foreign exchange rates are ultimately, of course, dependent on the general credit policy which is to be pursued, since it is very undesirable to fix rates which cause the external and internal values of the pound to differ widely. (Because this will cause the growth of a "black market"—see Appendix B.)

The working of the exchange equalisation fund has been a very valuable experience to the authorities. No doubt, with a socialised banking system, conditions would be very different, but the technique of control is certainly very much better known than it was even two years ago. The main objection which can be

levelled against the exchange equalisation fund is that though in course of time the authorities have become more successful in stabilising the exchange for certain periods, they seem to have no general policy to guide them, and no idea what rate of stabilisation is in fact the most convenient. If we assume that the general credit policy of a Socialist Government is determined mainly by considerations of the needs of home industries, the fixing of exchange rates depends on the collection of statistical material relating to internal and external prices, balance of payments, and the like, which are not at present available. Rule of thumb methods may be all very well in a *laissez-faire* economy: under Socialism they must give place to accurate calculations based on all kinds of relevant economic data. Until foreign trade is reorganised on a Socialist basis it is probable that no long-term policy can be laid down. In the short term it would no doubt be desirable (1) to fix for definite periods of time the gold value of sterling between certain fairly close points, and (2) to allow a forward market in foreign exchanges wherever possible.

(1) The methods used will be similar to those of the exchange equalisation fund, except that control will be made easier by reason of the foreign exchange monopoly. As soon as the collection of economic data was properly organised, and the long-term credit policy of the Government was worked out, foreign exchange rates would be fixed on a more scientific

basis. In any case it would probably be desirable to allow small fluctuations between two determined gold points, the gold points themselves being subject to alteration from time to time.

(2) The experience of the exchange equalisation fund seems to be that it is better to operate on the spot rates and allow the forward rates to move freely. There seems to be no reason, therefore, why forward rates should be fixed rigidly. The authorities would, therefore, organise a forward market, allow rates to fix themselves, and only operate on them when there was evidence of excessive speculation. Once it was evident that a firm control over spot rates had been established, speculation, whether in spot or forward rates, would very soon disappear.

CONCLUSION

In making the above suggestions I am fully aware that events may move very fast once a Socialist Government seizes power, and that many of the more detailed points may become quite irrelevant. If, for instance, confiscatory measures were introduced, or if a severe internal flight from the pound took place, or if all overseas investments were repudiated by our debtors or given back to our debtors by ourselves, many of the problems would take a different form. It is evident, however, that there are in general certain broad factors which do affect foreign exchange. I have, therefore, thought it best to consider them in

relation to the situation as it is to-day, because it is only by taking the concrete examples which we have before us that we can make plans to meet the new problems created by a revolutionary situation.

Appendix A

A NOTE ON FOREIGN EXCHANGE CONTROL IN GERMANY

The measures which were taken in Germany to safeguard the mark in 1931 were of three kinds:

(1) The standstill agreements.

(2) The surrender of foreign assets to the Reichsbank.

(3) The actual control over the purchase and sale of foreign exchange.

(1) Germany was able to conclude the standstill agreements because her short-term foreign debtors were in the main large foreign banks, with groups of which it was possible to make collective bargains. The agreements, it must be noted, refer only to short-term credits. They include provisions for the payment of interest at rates fixed by agreement, and also for the repayment of a certain proportion of the credits outstanding. Under the agreement of February 1933, such creditors who have registered or blocked accounts—i.e. holdings of marks which they may not change into other currencies—may purchase long-term German investments with them,

or transfer them to other foreigners for the purpose of investment or tourist expenditure in Germany.

(2) The surrender of foreign assets to the Reichsbank was decreed on July 18, 1931. All persons liable to German property tax were compelled to declare their holdings of foreign currency, bills, cheques, etc. (but apparently not foreign securities).

(3) By decrees of July 15, 1931, August 1, 1931, and October 2, 1931, the Reichsbank was given a monopoly of all foreign exchange dealings. All dealings had to be at the official rate and time dealings were forbidden. No foreign exchange could be obtained without a permit from the exchange control offices, which were installed in the local taxation headquarters. Reports of the uses made of foreign exchange had to be handed to the Reichsbank on the 6th of every month.

The last of these decrees withdrew all general permits from importers, who now obtained quarterly permits laying down the amounts of foreign exchange which would be available to them in each month of the quarter. Similarly, exporters had to hand to the nearest branch of the Reichsbank details of their consignments, while a similar form was handed to the customs officials when the goods left the country.

Appendix B

A NOTE ON "BLACK MARKETS"

Black markets—i.e. markets at which dealings will take place at unofficial rates—will tend to spring up

if private persons regard the official value of the pound as being too high. Experience shows that pressure to withdraw capital does not in general create black markets which last permanently, since it is not possible to put through big deals in them. Generally, black markets tend to spring up outside the country in which control is instituted, and dealings on them are mainly on account of current transactions.

Black markets in sterling would be established if there was a large discrepancy between the internal and external values of the pound, as a result of fixing the exchange too high. The reason that there are black markets in Russian roubles and Austrian schillings to-day is that there is this discrepancy between internal and external currency values. The main safeguard against them, therefore, is to relate the exchange rate as far as possible to the external and internal values of the currency (perhaps on a "purchasing power parity" basis), having due regard to the balance of payments.

Two final points may be noted. Suppose that the pound is overvalued at the official rate, and a black market in pounds is established abroad. It will be more profitable for sellers of sterling to deal at the official rate (i.e. importers, etc.) and buyers of sterling to deal at the black market rate. In the second place, if the official rate is fixed rigidly, all fluctuations will tend to be concentrated in the black market.

The existence of a permanent black market is a sure

sign that the official rate is not at the right level. This level must, in the case of a country for which international trade is of great importance, bear some relation to the levels of prices inside and outside the country. Only in this way can any planning authority decide whether, under a given set of circumstances, exports and therefore imports should be increased or decreased.

THE STATE AND INVESTMENT

E. A. RADICE

THE STATE AND INVESTMENT

INTRODUCTION

THE ACCUMULATION of capital is perhaps the central feature of modern industrial society. In essence it involves an abstention on the part of the community from directing all its available resources to the production of goods for current consumption, and, instead, the regular use of part of these resources for the production of other goods. These other goods may either be the instruments whereby production of all kinds may be increased, or capital goods proper, or goods which are, in effect, goods for consumption over a period of time, such as houses.

The financial mechanism which accomplishes this is in modern society exceedingly complicated. The abstention from consumption is effected by decisions on the part of individuals or corporate bodies to refrain from consuming all their incomes—i.e. to save, and thus to release claims on wealth, on purchasing power, which may be borrowed by those who wish to "invest" in the production of capital goods or goods for durable consumption. This twofold process of saving and investment is an essential part of the whole mechanism, and, with the development of financial technique, leads to the creation of specialised markets

and types of institutions which supply the different needs of savers and investors and furnish the link whereby the resources of the one class may be placed at the disposal of the other class.

It was inevitable, however, that with the complication of the mechanism linking savings and investments it became more and more difficult to ensure that by the private decisions of individuals or corporations, whether as savers or investors, a continuously smooth accumulation of capital should take place. At the present time there are few theories of the trade cycle which do not regard irregularities in the accumulation of capital as the most important factor in the development of booms and slumps. It is significant, however that it was the Socialist, Karl Marx, who was the first to see clearly that, as capital accumulated and economic centralisation increased, production under private enterprise would inevitably be made more and more difficult, because the smooth accumulation of capital under private enterprise would become impossible. For Socialists the State control of savings and investment is of course an essential part of their programme of public ownership and economic equality; but, even if this is the primary object of investment control, it is well to recognise that such control must also be an integral part of any programme which, while not primarily concerned with economic equality, aims at higher standards and greater security for the mass of the people. And for this

reason if for no other it must stand in the forefront of a Socialist programme ; for, unless Socialism can be of practical immediate use in increasing the workers' prosperity, it will not only have less chance of success, but may not even have the opportunity of carrying out any of its proposals.

During the present depression many capitalist States have taken an active part in the provision of capital for industries and in the general control of the financial side of economic life. In Germany, for instance, a rigid system of foreign exchange control has enabled the Government to regulate the movement of capital in and out of Germany. In the United States such organisations as the Reconstruction Finance Corporation have made it possible for banks and railways to obtain much-needed capital, and have generally encouraged projects of capital investment at a time when private capitalism was too timid or not sufficiently strong to take part in such ventures. But in these, as in other cases, control has been negative rather than positive ; introduced, that is, in the first instance, to mitigate the severer consequences of the depression rather than to act as a central part of a general policy of State economic planning. While, therefore, these foreign experiments may afford valuable lessons in the technique of control, the scope and objects of investment control by a Socialist Government must be concerned quite differently. It is with this that the present essay is mainly concerned.

THE ORGANISATION OF SAVINGS FOR INVESTMENT

In the early days of the capitalist system the accumulation of savings was a comparatively simple matter. Individual entrepreneurs used their own spare resources, and perhaps those of a few friends, to start business enterprises, and so the distinction between savings and investment was from the social point of view comparatively unimportant. With the growth of joint stock undertakings, however, people, by subscribing to the capital stock of a company, could share in its profits without being directly interested in its management. This led to the growth of a complex system of institutions centring round the new issue houses and the Stock Exchange, which enabled entrepreneurs interested in the development of new commercial and industrial enterprises to develop them not merely with their own savings, but with those of other people who played a more or less passive rôle once their savings had been handed over. As regards this country, this process developed most markedly in the field of foreign investment, but since the war has extended rapidly to cover a large part of the field of home investment as well.

In its most organised form this severance between those who provide savings and those who use them represents the ideally perfect form of the division of labour in the field of savings and investment, and was in Great Britain at any rate symbolic of the complete

development of *laissez-faire* capitalism. It never developed fully enough to cover the whole economic field, as private capitalists, particularly in home industry, continued to raise necessary funds without having recourse to the public, but nevertheless in the years immediately before the war it may be said that a large part, and perhaps the major portion, of new savings was organised for investment purposes in this way.

Although this system was complex in organisation, its general outline can be briefly stated. An entrepreneur, or group of entrepreneurs, about to form a new company, or desirous of obtaining additional capital for an already existing company, would approach a financial institution known as an issue house. Should the terms of the issue of capital be approved, the issue house would sponsor the issue and invite subscriptions from the public. Together with other institutions, it would " underwrite " the issue—i.e. guarantee that any portion of the issue not subscribed by the public would be met by the underwriters. For this, and for the general handling of the issue, fees would be charged which were deducted from the net amount of money which was actually handed over to the entrepreneur. Occasionally the whole issue might be bought up by the issue house at an agreed price, and then " placed " privately with the public or with other financial houses. The essence of the system was that the issue house would in a general way sponsor the issue, and, if the reputation of the

issue house was good, the public could be sure that the issue was honest and sound. Once the issue, which might be in the form of debentures, preference stock, or ordinary stock, was subscribed, it would under normal circumstances be traded on the Stock Exchange, and in this way a complex market grew up in which claims to debt on companies or ownership of companies were bought and sold. A variant on this method of accumulating savings was the investment trust. In essence, investment trusts are simply bodies of persons which buy and hold securities collectively. The reason for their growth was that private investors wished on the one hand to spread their investments, and on the other hand to gain the benefit of expert advice in the choice of investments. Instead of subscribing to new issues directly, or buying securities on the Stock Exchange himself, a person with no specialised financial knowledge could take up shares in a company which would do this work for him and in the profits of which he could share. Investment trusts started in Great Britain in the last quarter of the nineteenth century, and, after various fluctuations in fortune, are now one of the most important groups of security holders in the country. Since 1929 few new savings have flowed into them, but they remain a very powerful factor in the investment market, and are a good illustration of how the increasing complexity of financial organisation has led to further and further specialisation in the handling of savings and investments.

Finally there is a method by which entrepreneurs accumulate savings without going to the public—that is, by keeping undistributed the profits they make. Of recent years this has been one of the main sources of the total national savings, and it is interesting to notice that it is a reversion to the form of savings accumulation prevalent in the days before public issues of capital became popular. To-day the big joint stock companies find that capital expansion can often best be financed with their own savings, and are thus making corporate a process which for long has been individual. These savings, or increases in reserves, may be used for immediate extensions of plant, buildings, working capital, etc., may be invested in securities pending such expansions, or may be used in debt repayment.

While the comparative unwillingness of the public to subscribe capital individually and directly to business enterprises has of recent years led companies to depend more and more on their own corporate savings, it has also brought about a growth in institutions with which the public place their savings for the purpose of saving up for their old age or their dependants where considerations of safety are more important than those of high return. Such institutions are insurance companies, building societies and savings banks. Insurance companies use these savings in much the same way as the investment trusts, but have a greater proportion of safety-first investments ; building societies use them largely for financing the building of houses, but also

hold securities, particularly when the demand for building finance is low; while savings banks rely mainly upon British Government and trustee securities. At this stage the divorce between savings and investment becomes absolute. In subscribing to an ordinary issue, or even to an investment trust issue, the man with savings, though playing a passive rôle in the running of business, is actively interested in the success or failure of that business. In the case of insurance companies, building societies, and savings banks, however, so long as there is an assurance that these institutions themselves are sound, the man with savings is merely interested in seeing that his savings are safe and he gets a reasonable return on them. He is indifferent as to how in fact his savings are used, and the fact that there are no market fluctuations of his claims on the institutions (as there are, say, in the case of British Government securities) gives them a fixed value for him, which is apparently quite independent of the general economic life of the community.

Finally, there is another important source of savings to-day which is similar to the savings accumulated by companies. These savings arise out of the debt repayments and sinking funds of the Government and other public bodies, and out of the capital expenditure of these bodies which are financed out of general revenues. In the latter case these savings are, of course, immediately invested, while in the former they become available for investment elsewhere.

How far do each of these items enter into the total of national savings? The question is not an easy one to answer, but estimates have been made as to the size of most of them. The following estimates for the years 1924–31 are those of Mr. Colin Clark.[1]

(£ million)	1924	1925	1926	1927	1928	1929	1930	1931
Undistributed profits. Deduct	167	162	128	186	168	169	134	131
losses and dividends (if any) of concerns making losses	−9	−17	−19	−20	−14	−16	−46	−78
	158	145	109	166	154	153	88	53
Net surplus from taxation by State, L.A.'s and insurance funds	81	71	56	116	106	71	35	25
Capital outlay on roads not met by loans	15	17	17	18	17	18	18	20
	96	88	73	134	123	89	53	45
Increase in liabilities of:								
Insurance Companies	42	53	52	49	50	49	41	50?
Building Societies	19	24	23	28	44	43	56	43
Savings Banks	11	9	−2	4	11	0	12	?
	72	86	73	81	105	92	109	100?
Grand total of above items	330	319	255	381	382	334	250	198?

This total includes the contributions to new issues made by insurance companies, etc., but does not include the net savings made by private persons on their own account. This item is probably not very

[1] *The National Income 1924–1931*, p. 138.

large. To quote Mr. Clark[1]: "*The net savings made by the wealthy classes out of their own incomes have now become very small, and in many cases they are actually overspending their incomes and living on their capital.* The only savings made by the wealthy classes are those made for them by the company official and the tax-collector." (The italics are Mr. Clark's.)

In a general year, then, the net available savings of the country, after allowing for depreciation, writing down stocks, etc., may be put at rather under £400 million. It may be noted in passing that the total of new capital issues offers no guide to the total net savings. They are considered in detail in another section in this book, which makes it clear that in boom years particularly only a small proportion of the totals represent net investments in new capital, the rest going towards the purchase of existing assets, goodwill, etc., of all kinds. The reader is referred to the statistical analysis given in that essay, which makes plain that the new net investment obtained from new capital issues fluctuates far less wildly from year to year than the totals of new capital issues would lead one to imagine.

This brief analysis shows that the transition from a chaotic to a planned society is no simple matter so far as the accumulation of savings is concerned, but it is plain that, because this accumulation is far less of an individual matter than it used to be, the purely

[1] *The Control of Investment*, by Colin Clark (New Fabian Research Bureau and Victor Gollancz Ltd., 6*d*.).

technical problem of control is a manageable one.

First of all there must be control over the big institutions, such as insurance companies and building societies. This problem is considered in greater detail elsewhere in this book. It is worth noticing, however, that these bodies which from the point of view of the ordinary public are fundamentally savings institutions, where funds may be devoted generally to all kinds of investments, may require altogether different treatment from that given to ordinary nationalised industries, where a host of problems arises as to whether any surplus shall be made, and, if so, how it shall be used.[1]

As regards industries not yet nationalised, it is difficult to see how adequate control can be obtained over undistributed profits. In the long run, taxation will be the effective weapon, and the State will therefore have to face the necessity of taxing for purposes of saving as well as taxing for ordinary revenue purposes. This is, of course, only an extension of the present system whereby the State taxes for the purposes of sinking fund payments—with the big difference that in this case the proceeds of taxation will be used for investment proper and not mainly for the paying off of debt. Similarly, it might be found necessary for nationalised industries to be taxed or to be required to make definite contributions towards the fund for national savings. Once the principle is

[1] For a discussion of this problem see G. D. H. Cole's *The Essentials of Socialisation* (New Fabian Research Bureau, 3*d*.).

grasped that the State can tax in order to save and invest, and not only in order to spend and consume, many of the financial bogeys which high taxation creates in the minds of capitalists, and even of Socialists, disappear. For if industries still remaining in private hands are foolish enough to let their capital depreciate, then the national economy as a whole will not suffer so long as the State itself creates similar industries with its accumulated savings. Nevertheless, it will probably be advisable in the early stages of socialisation to encourage rather than to discourage the accumulation of capital by private industrial concerns, for it may be some time before the State is in a position to take this matter up itself, when it will be mainly engaged in the reorganisation of big nationalised industries.

In the same way, part of the proceeds of the taxes on private individuals should be used for the purpose of accumulating savings. It has long been urged that the comparatively high income and surtax levels prevailing in recent years have been a deterrent to saving, and that the national economy as a whole has suffered in consequence. How far this is true is discussed in another pamphlet.[1] It is obvious, however, that if the proceeds of death-duties were used for capital rather than for current purposes, this objection would largely fall to the ground. Death-duties are, even at the present time, an important factor in

[1] *Taxation under Capitalism: The Effects on the Social Services* (New Fabian Research Bureau and Victor Gollancz Ltd., 6*d*.).

bringing about a redistribution of wealth. Their extension would bring about a sharp reduction in the inequalities of income and of the social distinctions which inherited wealth brings with it. Inheritance taxes should, therefore, be sharply raised, and the proceeds from them devoted partly to capital accumulation and partly to acquiring fixed capital assets for the State. The acquisition of capital assets will follow from the necessity of allowing duty to be paid "in kind" as well as in cash, as a very high rate of duty would make it virtually impossible to liquidate estates sufficiently to pay the whole duty in cash.

Finally, there will be the problem of how to control the individual savings—at the present time not very large in amount—that go into the new issue market. Obviously Government issues, and those of nationally owned industries, will take up an even greater proportion of these savings than they do now, and so far as these issues are concerned there is no problem. Just as the Socialist Government in Russia appeals to the public from time to time for subscriptions to internal development loans, so a Socialist Government in Great Britain would, in the early stages at any rate of the transition to Socialism, have to rely to some degree on this method of gathering together the savings of private individuals. As to what sort of control will be instituted over issues made by non-nationalised enterprise, the question is one which cannot be considered before some suggestions have

been given as to the rôle which the State must play in the active direction of investment.

STATE DIRECTION OF INVESTMENT

We have seen that in the very early days of capitalism the process of saving and investment was an individual one on the part of the entrepreneur, and that consequently there was little or no difference between these two aspects of capital accumulation. With the gradual concentration of capital, however, production became a social rather than an individual process, with the result that the buying of capital goods—i.e. investment—came very largely to be directed by corporations, while saving remained mainly individual. This distinction, one may note in passing, gave rise to a very definite clash of interests with the capitalist class, between the individualist consumer section on the one hand, who did most of the work of saving, and the producer interests on the other hand, who invested those savings. In post-war years, however, the increasing difficulties which world capitalism has had to face have led very largely to the abandonment of individualisation in saving so far as interested participation in the work of capital accumulation is concerned. On top of the rise of the big insurance companies, building societies, etc., came the tendency for industrial and commercial corporations to perform their own saving, with the result that, taking these two factors together, the process of saving

as well as that of investment has ceased to be an individual matter, and has become corporate or social. This, of course, is merely one aspect of the unification of the capitalist class which has recently been going on, and which is paralleled, for instance, in the political field by the virtual fusion of Conservative and Liberal Parties all over the world. The object of a Socialist Government will, therefore, be to carry on the socialisation of saving and investment which has advanced so rapidly under capitalism, using it, however, as an instrument whereby capitalism can be overthrown instead of retrenched.

The programme of the Labour Party includes the setting up of a National Investment Board, with powers—not very strictly defined as yet—to control in a general way the investment of capital funds. The brief analysis of the chief methods of saving now in operation in this country may help to define its functions more clearly, and it is well to remember that its workings cannot be haphazard, or even simply in accordance with the demands for fixed capital on the part of nationalised industries. It must work in harmony with all the needs of the community on the side of saving as well as on the side of investment, and serve in general as the distributor of that part of the national income which the community decides to set apart for investment purposes. It must, therefore, in some form or another provide machinery which will regulate the £400 million or so which can

normally be expected to appear as national savings.

At this point it becomes clear that the first keys to the situation are the building societies and the insurance companies. In the year 1929 we have seen that perhaps half the national savings were done by them, by the savings banks, and by public authorities, and during the depression years this proportion has considerably increased. If, therefore, control over the investment policies of these big institutions is obtained, and the savings accumulated through them, as well as through the savings banks and public authorities, are placed at the disposal of the National Investment Board, the latter would have a sum more than sufficient for the capital expenditure which is now normally undertaken by public bodies, as well as that part of house-building which is not, and probably the capital requirements of the various public bodies now in existence. At the same time the National Investment Board, as and when it thought fit, might raise capital from the public much in the same way as is done by public bodies at the present time.

Against the funds flowing into it from insurance companies, building societies, savings banks, and private persons, the National Investment Board would issue medium- and long-term bonds. The board would then loan these sums to the Government, local authorities, and the various public authorities running socialised enterprises. Any savings or sinking fund repayments, whether resulting from surpluses in the

operation of industry or from taxation by means of death-duties, etc., would be used to repay debts outstanding to the National Investment Board, and thus release sums for further capital development. The bonds issued by the board should be of a fixed-interest-bearing character, and should carry a Government guarantee.

In this way the board would, in effect, have the handling of the long-term debts of the Government, local authorities, and socialised industries so far as the technical operations of raising and lending capital are concerned, while the handling of the short-term debts, whether in the form of Treasury or commercial bills or of ordinary loans and advances, would come within the sphere of the Bank of England and the socialised commercial banks.

Thus without at this stage prejudging the issue as to how exactly the decisions as to the amount and direction of capital investment would be made, we can form an idea of how a National Investment Board would co-ordinate and socialise a large proportion of the national savings and investment. Suppose, to take an obvious instance, that a Socialist Government decided to embark on a large programme of house-building. This might be done either by setting up a National Housing Corporation or through the existing local government bodies. In either case the funds would be raised through the National Investment Board, which would have at its disposal the savings flowing into the building societies, and which would

ensure that such savings were used to finance public house-building and not private real-estate speculation. Similarly, the National Investment Board would advance to socialised industries those new capital funds which they would not be required to accumulate out of their own surpluses, and would also handle any taxes which might be placed on them for the general purposes of national savings.

In addition, the National Investment Board would have to have the handling and control of the various assets now held by insurance companies, building societies, and savings banks, as well as miscellaneous properties in the form of securities, land, etc., which would accrue to it as a result of the imposition of the revised death-duties mentioned above. The liquidation and transfer of these assets to the appropriate socialised institutions, or their cancellation (in the event of their being the board's own bonds), would be a lengthy process, calling for considerable technical skill, but one which would be necessary unless the situation were so revolutionary as to destroy all pre-existing property relationships.

So far the functions of the National Investment Board are not hard to define, but we must now consider two very difficult problems with which it will have to deal: firstly, the control of the export of capital; and secondly, the control over the private investment of capital and the existing financial institutions in the City of London which affect long-term investment.

The question as to how far a Socialist State as industrially advanced as this country should export capital is one to which no hard and fast answer can be given. There are some who maintain that any surplus in balance of payments should be taken up by increased imports which would lead to higher consumption standards rather than by increased savings and investment which an export of capital would involve. But, discussed in the abstract, the whole problem lacks reality. It may be vital for world economic progress that the industrially advanced countries should export capital goods for the purposes of countries less industrially advanced, in much the same way as it is vital for every country to save part of its national income. On the other hand, foreign lending for unproductive purposes such as happened on such a large scale in the years 1924–28 is hardly likely to benefit the countries which make such loans. Conditions in the international market often vary even more than in the home market, and decisions as to capital export must therefore be governed by concrete situations.

What is necessary, however, is to devise some machinery whereby the decisions of the State regarding the export of capital may be carried out. From time to time in recent years the Bank of England, in consultation with or at the request of the Treasury, has placed an unofficial embargo on new overseas issues. But it is quite evident that this in itself need not

necessarily have any effect on the movements of capital, which may take place in buying and selling existing securities just as easily as by buying or selling new securities. In the short-term field, it is true, the creation of the Exchange Equalisation Fund has created a very valuable mechanism which can partly control the flow of funds, but it is admittedly powerless in the event of a continuous drain in either direction.

For a more detailed discussion of the problem the reader is referred to the section on "The Problem of Foreign Exchange Control," where the various possibilities are discussed. The task of the National Investment Board would be in general to undertake the handling of such exports of long-term funds as may be thought desirable by the exchange authorities. It is probable that the export of capital might largely take the form of direct loans by the British Government to foreign Governments—e.g. a loan to Russia might very well be in this form—or of medium-term credits for financing the export of machinery, etc. As, however, the question of the movements of long-term funds is to-day a matter for Governments and central banks rather than for individuals, the private issue of foreign capital would very probably be discouraged, though companies operating wholly or partly abroad might invest their undistributed profits in foreign countries should the foreign exchange authorities think fit.

This brings us immediately to the whole problem of the regulation and control of private investment. We

have seen that complete control over the investment of the undistributed profits made by private companies still left in private hands is impossible to obtain, except indirectly through the control of the products which such investment funds may purchase, and through taxation. Thus, so long as private saving and private investment remain undifferentiated, the National Investment Board will not be able to intervene directly. But whenever private savings or private investments in the form of securities are traded in a market or handled by intermediary organisations, it will be possible, and indeed necessary, for the National Investment Board to devise some mechanisation of supervision and control. The question, therefore, is how far the actions of issue houses, the Stock Exchange, and investment bankers should generally be regulated. There are some, indeed, who hold that such regulation should be the main, if not the sole, function of the National Investment Board, and that the time is not yet ripe for an organisation whose task will be the general supervision of national savings and investment. One cannot, however, but suspect that such an attitude is due to the idea that the main task of a Socialist Government is to destroy the power of certain sections of finance capitalism rather than to reorganise the whole policy of national economic and social life.

There is probably no part of our economic organisation that needs thorough reform more than the buying and selling of securities. The British public has, it is

true, been spared the predatory ravages of the American investment bankers, but it will not easily forget the Farrows and Hatrys who in the past have swindled it, or the numerous smaller fry who have frittered away its savings in speculation. Abuses will, of course, exist so long as there is any private raising of capital. But it is unwise to assume that the National Investment Board will immediately be able to take over all the functions at present performed by private institutions, just as it would be foolish to imagine that private operation of certain industries would not continue for some time after the coming to power of a Socialist Government.

One of the first tasks of the National Investment Board in this field will be to reform the methods of placing new issues with the public. The section on "Recent Capital Issues" shows very clearly that in prospectuses there is no indication at all of how the bulk of the money raised is to be spent, while a large part of the remainder is eaten up in buying up existing interests of all kinds and in paying commissions, fees, and rake-offs to financiers. The board will have to ensure as far as possible that new money raised from the public will be applied to the creation of real capital assets. First of all, it will have to require that all proposals for the public issue of new capital will have to be submitted to it for approval, and only if the issue is in the public interest will it be allowed. In the second place, all prospectuses will be required

to be set out in a prescribed form, giving accurate details of the objects for which the money is to be used, and of the past financial history (if any) and proposed future operations of the company in question. While it would probably be immediately undesirable to go as far as the Securities Act of 1933 in America, promoters and issue houses should be made liable to very severe penalties not only for giving false information, but also for withholding relevant information. On the other hand, the approval of the board should not be taken by the investor to mean that the board is in any way responsible for the issue or guarantees the accuracy of the information given in the prospectus. In this way some control on the one hand will be obtained over the uses to which new money will be put, and some guarantee given that it will be for productive purposes, and, on the other hand, certain safeguards will be secured in the interests of those members of the public who have savings to invest.

More difficult to control, but equally important, are some of the less public transactions of investment bankers, such as the private purchase or placing of blocks of securities by one of a group of institutions. Thus, instead of a public issue to which private persons can subscribe directly, an investment house will subscribe all the money towards an issue, and unload the shares to the public at a later date. This practice is less developed in this country than in the United States, where during the boom years the

offering to the public of securities by investment bankers was a common practice. But, though less common in Great Britain, this practice is not less profitable, as the recent Boots share deal shows, in which the financial group interested are said to have made a profit of £1,000,000 or 25 per cent of the purchase price, within a few weeks. In such cases the only means of publicity at present is that some sort of prospectus or announcement has to be issued before the shares can be introduced on the Stock Exchange. Obviously this is not sufficient, and the National Investment Board will have to apply the same rules to this method of raising money from the public as in the case of public issues. At the same time, it should have powers to give general publicity to the transactions of investment bankers such as that given by the United States Senate through its inquiries into the activities of American bankers in the securities markets.

Finally, some control will have to be obtained over the Stock Exchange. There are some Socialists who, while they do not propose the complete and immediate abolition of sale of securities as such, maintain that the Stock Exchange is merely an organisation to promote speculation, and should therefore be abolished. Without going into the question of how far speculation is or is not desirable in an economic society in which private enterprise still plays a part, it can at least be said that, so long as the private holding of securities continues, it will be convenient to have a market in

which they can be bought and sold. Even in the U.S.S.R., Government issues and bonds issued in connection with internal development loans are traded in the Moscow Stock Exchange, and, so long as some control is exercised over it, there is no reason why the London Stock Exchange should not continue to perform its useful functions, provided that its more undesirable ones cease.

At the moment the actions of Stock Exchange bodies and dealers (jobbers) are fairly rigidly limited by rules laid down by the Stock Exchange Committee. It seems desirable that the members of the committee, or at least a majority of them, should be appointed by, and be responsible to, the National Investment Board. The function of the committee would be, as now, threefold. Firstly, rules have to be laid down regarding the actual technique of trading—e.g. settlements, clearing, etc., which need not here concern us. Secondly, general supervision will be exercised over the professional conduct of the members of the Exchange, and in this respect there might be a very considerable tightening up of existing rules. Thirdly, and perhaps most important, the committee will have to decide on whether or not any given security may be traded in the Exchange. Here far-reaching reforms are necessary. Not only should very considerable care be exercised in giving leave to introduce new securities, but many existing securities should be eliminated from the official lists. The Stock Exchange Committee

should, in fact, act as a vigilance committee on behalf of the public and the State, and not allow trading in the securities of unsound or fraudulent concerns. This will naturally entail a great deal of work, but there are large numbers of research workers at present attached to individual Stock Exchange firms whose talents could no doubt be far more suitably devoted to protecting the interests of the public.

Finally, as regards speculation, it would seem to be undesirable to prohibit bull and bear trading. At the present moment Stock Exchange speculation is financed largely by the joint stock banks. Their nationalisation, therefore, would afford a direct means of controlling speculation, and a far more effective one than the mere regulation of trading technique.

The scope of the National Investment Board has now been outlined. It remains to give a very brief account of its possible composition and its relations with other public bodies.

The primary object of a Socialist Government will presumably be to institute a planned economy in the place of the present profit economy, because without such a planned economy the abolition of private exploitation is impossible. It may be assumed, then, that some supreme body (the composition of which is not relevant to the present discussion) will be set up to work out and carry through the Socialist economic plan. The function of investment is, as we have seen, an all-important one, and the National Investment

Board will therefore be one of the most important organs through which the supreme economic body will work. The general outline of policy will be laid down from above, but the technique of carrying out that policy will be the work of the board. It is therefore essential that the officers of the National Investment Board should be full-time experts, with adequate technical knowledge of all questions coming within the scope of the board's activities ; for, since the board will not be engaged in the political work of laying down general policy, the sole criterion by which its officers should be appointed is technical qualifications, provided always that the persons appointed are loyal to the State, and will not obstruct its policy.

Apart from the relations of the board with industries which would be nationalised, it will by its very nature be in close contact with various existing State departments. In the provision of houses and buildings it will have to work in with the Ministry of Health and the Office of Works ; it will have to consult with the Ministry of Agriculture in the provision of agricultural credits, and with the Board of Trade and the Department of Overseas Trade in the general financing of home industry and exports. Contact between the National Investment Board and such departments would be maintained primarily through the supreme economic body, but also directly by joint discussions on the details of particular problems affecting the departments concerned.

It is only natural, however, that, since the main concern of the board will be financial, almost the whole of its work will be done in conjunction with the other finance departments of the State. It has been proposed that the management of the long-term national debt should be in the hands of the board : this will require daily and continuous contact with the Treasury. Naturally it will also have to work in very closely with the nationalised Bank of England and the nationalised commercial banks.

How exactly these various public bodies would work in with each other it is impossible to lay down beforehand. For the execution of far-reaching national schemes administrative machinery has often to be improvised on the spot, and varied as circumstances require. The experience of this country during the war, and, more recently, of the United States under President Roosevelt, shows that the growth of the apparatus of government must be adapted to the ever-changing needs of the immediate situation. Nevertheless, it is possible to give an outline of the kind of work a body undertaking the control of capital accumulation will have to do : and that such a body will be one of the central links in the carrying out of a Socialist plan will be admitted by all those who realise the important rôle played by capital accumulation in modern economic society.

THE END